

November 2011

FINANCIAL AUDIT

Securities and Exchange Commission's Financial Statements for Fiscal Years 2011 and 2010

U.S. Government Accountability Office



YEARS

1921-2011

ACCOUNTABILITY ★ INTEGRITY ★ RELIABILITY



Highlights of [GAO-12-219](#), a report to the Chairman, United States Securities and Exchange Commission

Why GAO Did This Study

Pursuant to the Accountability of Tax Dollars Act of 2002, the United States Securities and Exchange Commission (SEC) is required to prepare and submit to Congress and the Office of Management and Budget audited financial statements. Pursuant to the Securities Exchange Act of 1934, amended in 2010 by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), SEC is also required to submit audited financial statements for the Investor Protection Fund (IPF) to Congress. GAO, under its audit authority, audited SEC's and IPF's financial statements to determine whether (1) the financial statements are fairly presented, and (2) SEC maintained effective internal control over financial reporting. GAO also tested SEC's compliance with selected provisions of laws and regulations. In accordance with the 1934 act, as amended by the Dodd-Frank Act, GAO also reported on SEC's assessment of its internal control over financial reporting.

What GAO Recommends

GAO is not making recommendations in this report, but will be reporting separately on the control issues identified during its audit, along with recommendations for corrective actions.

In commenting on a draft of this report, SEC stated that, as part of its strategy for addressing financial reporting control issues, SEC will complete migration of its core financial system to a federal government shared service provider in fiscal year 2012. SEC also plans to continue to remediate deficiencies in other areas.

View [GAO-12-219](#). For more information, contact James R. Dalkin, (202) 512-9406, or dalkinj@gao.gov

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What GAO Found

In GAO's opinion, SEC's fiscal years 2011 and 2010 financial statements are fairly presented in all material respects. Also in GAO's opinion, IPF's fiscal years 2011 and 2010 financial statements are fairly presented in all material respects. In addition, GAO concluded that although internal controls could be improved, SEC maintained, in all material respects, effective internal control over financial reporting for both the agency as a whole and IPF as of September 30, 2011. GAO's conclusion on the effectiveness of SEC's internal control over financial reporting is consistent with SEC's assessment of its internal control over financial reporting as of September 30, 2011. GAO found no reportable noncompliance for either SEC or IPF in fiscal year 2011 with the provisions of laws and regulations it tested.

During fiscal year 2011, SEC made important progress in addressing previously reported material weaknesses in internal control over its information systems and over its financial reporting and accounting processes. Because of these improvements, GAO concluded that the deficiencies that comprised these weaknesses no longer constitute material weaknesses. However, GAO also concluded that, because of the remaining control deficiencies along with newly identified deficiencies in fiscal year 2011, SEC had significant deficiencies in its internal control in four areas: (1) information security, (2) financial reporting and accounting processes, (3) budgetary resources, and (4) registrant deposits and filing fees. These significant deficiencies pertain to SEC's financial reporting, but not that of IPF because of the nature of IPF's financial transactions during fiscal year 2011. While these significant deficiencies are not material weaknesses, they nonetheless warrant the attention of those charged with SEC's governance. SEC's ability to establish and maintain effective internal control over financial reporting remains at risk until it can reduce its reliance on compensating manual financial reporting and accounting processes.

GAO will be separately reporting at a later date to SEC on additional details regarding these significant deficiencies along with recommendations for corrective action. GAO noted other matters involving SEC's internal control that were less significant than a material weakness or significant deficiency and will also be reporting separately to SEC management on these matters.

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Abbreviations

FMFIA	Federal Managers' Financial Integrity Act
IPF	Investor Protection Fund
SEC	United States Securities and Exchange Commission
SRO	Self-Regulatory Organization

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United States Government Accountability Office
Washington, D.C. 20548

November 15, 2011

The Honorable Mary Schapiro
Chairman
United States Securities and Exchange Commission

Dear Ms. Schapiro:

The accompanying report presents the results of our audits of the financial statements of the United States Securities and Exchange Commission (SEC) and its Investor Protection Fund (IPF)¹ as of and for the fiscal years ended September 30, 2011, and 2010. The Accountability of Tax Dollars Act of 2002 requires that SEC prepare and submit audited financial statements to Congress and the Office of Management and Budget. The Securities Exchange Act of 1934, as amended in 2010 by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), requires SEC to prepare and submit a complete set of audited financial statements for IPF to Congress.² We agreed, under our audit authority, to audit SEC's and IPF's financial statements. Section 963 of the Dodd-Frank Act further requires that (1) SEC submit a report to Congress describing management's responsibility for internal control over financial reporting and assessing the effectiveness of such internal control during the fiscal year; (2) the SEC Chairman and Chief Financial Officer attest to SEC's report; and (3) GAO submit a report to Congress evaluating the effectiveness of SEC's internal control over financial reporting and assessing, attesting to, and reporting on SEC management's internal control assessment.³ Accordingly, this report also responds to our requirement under the Dodd-Frank Act.

This report contains our (1) unqualified opinions on SEC's and IPF's fiscal years 2011 and 2010 financial statements; (2) opinion that, although internal controls could be improved, SEC maintained, in all material

¹IPF was established in 2010 by section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to fund the activities of SEC's whistleblower award program and the SEC Office of Inspector General suggestion program. IPF is a separate fund within SEC and its financial statements present a segment of SEC financial activity. Accordingly, IPF's financial transactions are also included in SEC's financial statements.

² Section 21F(g)(5) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-6(g)(5).

³ Dodd-Frank Act, Pub. L. No. 111-203, § 963, 124 Stat. 1376, 1910 (July 21, 2010)(*codified at* 15 U.S.C. § 78d-8).

respects, effective internal control over financial reporting for both the agency as a whole and IPF as of September 30, 2011;⁴ and (3) conclusion that our tests of SEC's compliance with selected provisions of laws and regulations disclosed no instances of noncompliance for either the agency as a whole or IPF for fiscal year 2011.

We are sending copies of this report to the Chairmen and Ranking Members of the Senate Committee on Banking, Housing, and Urban Affairs; the Senate Committee on Homeland Security and Governmental Affairs; the House Committee on Financial Services; and the House Committee on Oversight and Government Reform. We are also sending copies to the Secretary of the Treasury, the Director of the Office of Management and Budget, and other interested parties. In addition, this report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you have questions about this report, or if I can be of further assistance, please contact me at (202) 512-9406 or dalkinj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix II.

Sincerely yours,



James R. Dalkin
Director
Financial Management and Assurance

⁴ Section 963(b) of the Dodd-Frank Act also requires, effective for fiscal year 2011, GAO to assess the effectiveness of SEC's internal control over financial reporting and SEC's assessment of the same. Our audit satisfies these requirements. See 15 U.S.C. § 78d-8(b), which codifies this requirement.



United States Government Accountability Office
Washington, D.C. 20548

To the Chairman of the United States Securities and Exchange Commission

We agreed, under our audit authority, to audit the financial statements of the United States Securities and Exchange Commission (SEC) and the financial statements of SEC's Investor Protection Fund (IPF). The Securities Exchange Act of 1934, as amended in 2010 by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), requires that SEC provide separate audited financial statements for IPF to Congress.¹ Since IPF is a fund within SEC, its financial transactions are also included in SEC's overall financial statements. In accordance with the Dodd-Frank Act,² we are required to assess the effectiveness of SEC's internal control over financial reporting, evaluate SEC's assessment of such effectiveness, and attest to SEC's assessment of its internal control over financial reporting.

In our audits of SEC's financial statements and IPF's financial statements for fiscal years 2011 and 2010, we found

- the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles;
- although internal controls could be improved, SEC maintained, in all material respects, effective internal control over financial reporting for both the agency as a whole and IPF as of September 30, 2011; and
- no reportable noncompliance in fiscal year 2011 with provisions of laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions; (2) our conclusions on Management's Discussion and Analysis and required supplementary and other accompanying information; (3) our audit objectives, scope, and methodology; and (4) SEC's comments on a draft of this report.

¹ Section 21F(g)(5) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-6(g)(5).

² Dodd-Frank Act, Pub. L. No. 111-203, § 963, 124 Stat. 1376, 1910 (July 21, 2010)(*codified at* 15 U.S.C. § 78d-8).

Opinion on SEC's Financial Statements

The financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, SEC's assets, liabilities, and net position as of September 30, 2011 and 2010, and its net costs, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended.

Opinion on IPF's Financial Statements

The financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, IPF's assets, liabilities, and net position as of September 30, 2011 and 2010, and its net costs, changes in net position, and budgetary resources for the fiscal years then ended.

Opinion on Internal Control

Although certain internal controls could be improved, SEC maintained, in all material respects, effective internal control over financial reporting as of September 30, 2011, that provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the agency's and IPF's financial statements would be prevented or detected and corrected on a timely basis. Our opinion is based on criteria established under 31 U.S.C. § 3512 (c), (d), commonly known as the Federal Managers' Financial Integrity Act of 1982 (FMFIA). As discussed below, our fiscal year 2011 audit identified significant deficiencies in SEC's internal control over financial reporting.³ These significant deficiencies pertain to SEC's financial reporting, but not that of IPF because of the nature of IPF's financial transactions during fiscal year 2011. Our opinion on SEC's internal control is consistent with SEC's assertion that its internal controls over financial reporting, both for the agency as a whole and for IPF, were operating effectively as of September 30, 2011, and that no material weaknesses were found in the design or operation of the

³ A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

controls.⁴ SEC management's assertion is included in its Management's Discussion and Analysis included in this report.

In our 2010 audit report,⁵ we concluded that SEC did not maintain effective internal control over financial reporting as of September 30, 2010, because of material weaknesses⁶ in SEC's internal control over (1) information systems and (2) financial reporting and accounting processes. Based on SEC's efforts to address the deficiencies we previously found in its controls over information systems, and the improvements we found in this area during our fiscal year 2011 audit, we concluded that the remaining deficiencies in information systems no longer constitute a material weakness. However, these remaining deficiencies in controls over information systems could adversely affect SEC's information security and its financial reporting relevant to these information systems. Therefore, we considered SEC's controls over information security to be a significant deficiency in fiscal year 2011. This significant deficiency is discussed in more detail later in this report.

During fiscal year 2011, SEC also made progress in addressing the five areas of internal control deficiencies that collectively comprised the material weakness over financial reporting and accounting processes in fiscal year 2010. Specifically, SEC sufficiently addressed the deficiencies regarding SEC's internal controls related to accounting for disgorgement

⁴ Dodd-Frank Act, Pub. L. No. 111-203, § 963, 124 Stat. 1376, 1910 (July 21, 2010)(*codified at* 15 U.S.C. § 78d-8), requires that (1) SEC submit a report to Congress describing management's responsibility for internal control over financial reporting and assessing the effectiveness of such internal control during the fiscal year, (2) the SEC Chairman and Chief Financial Officer attest to SEC's report, and (3) GAO submit a report to Congress evaluating the effectiveness of SEC management's internal control over financial reporting and management's assessment of such control and attesting to the internal control assessment made by SEC. SEC conducted an evaluation of its internal control over financial reporting in accordance with the Office of Management and Budget's Circular No. A-123, *Management's Responsibility for Internal Control*, based on criteria established under FMFIA.

⁵ GAO, *Financial Audit: Securities and Exchange Commission's Financial Statements for Fiscal Years 2010 and 2009*, [GAO-11-202](#) (Washington, D.C.: Nov. 15, 2010).

⁶A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct, misstatements on a timely basis.

and penalties⁷ and reporting required supplementary information such that we no longer consider these two areas to be control deficiencies as of September 30, 2011. SEC also addressed some of the issues comprising deficiencies in its financial reporting and accounting processes, budgetary resources, and registrant deposit and filing fee transactions that were also part of the material weakness in internal control over financial reporting in fiscal year 2010. However, our work in fiscal year 2011 showed continuing deficiencies in the design and/or implementation of effective internal control for each of these three areas that were significant to SEC's financial reporting as of September 30, 2011. Therefore, while they no longer collectively represent a material weakness, we considered each of these remaining continuing deficiencies to represent a significant deficiency in internal control in fiscal year 2011. These three significant deficiencies are discussed later in this report.

For all significant errors and issues that were identified, SEC made necessary adjustments to the financial statements, the notes accompanying the financial statements, and other required supplementary information, as appropriate, and was therefore able to prepare financial statements that were fairly presented in all material respects for fiscal years 2011 and 2010. Although the significant deficiencies in internal control did not materially affect SEC's fiscal year 2011 financial statements, misstatements may occur in other financial information reported by SEC and not be prevented or detected because of these significant deficiencies.

The four significant deficiencies as of September 30, 2011, although not considered to be material weaknesses, are important enough to merit the attention of those charged with governance of SEC. We will be reporting additional details concerning these four significant deficiencies separately to SEC management, along with recommendations for corrective actions. We also identified other deficiencies in SEC's system of internal control that we do not consider to be material weaknesses or significant deficiencies. We have communicated these matters to SEC management informally and, as appropriate, will be reporting them separately to SEC at a later date.

⁷A disgorgement is the repayment of illegally gained profits (or avoided losses) for distribution to harmed investors whenever feasible. A penalty is a monetary payment from a violator of securities law that SEC obtains pursuant to statutory authority. A penalty is fundamentally a punitive measure, although penalties occasionally can be used to compensate harmed investors.

Compliance with Laws and Regulations

Our tests of SEC's compliance with selected provisions of laws and regulations for the agency as a whole and IPF for fiscal year 2011 disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards. The objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

As disclosed in note 14C to SEC's financial statements, a GAO legal decision,⁸ issued on October 3, 2011, concluded that SEC did not properly record its obligation when it entered into a 10-year lease by failing to record its total liability under the lease at the date when the lease was signed. Specifically, GAO concluded that SEC did not have the authority to record an obligation for an amount less than the government's full liability under the lease and was therefore in violation of the recording statute.⁹ SEC made adjustments to its budget accounts in order to properly record any lease agreements it entered into during fiscal year 2011. SEC also made an adjustment to its budget accounts in fiscal year 2011 to obligate \$778 million for the full amount of its lease obligations it entered into during fiscal years 1990 through 2010. However, since SEC lacked sufficient budgetary authority to cover the \$778 million in lease obligations, it incurred violations of the Antideficiency Act for fiscal years 1990 through 2010, the years in which these obligations were incurred.

Consistency of Other Information

SEC's Management's Discussion and Analysis, required supplementary information, and other accompanying information contain a wide range of information, some of which is not directly related to the financial statements. We did not audit and we do not express an opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with SEC officials. On the basis of this limited work, we found no material inconsistencies with the financial statements, U.S. generally

⁸B-322160, Oct. 3, 2011 (*Securities and Exchange Commission—Recording of Obligation for Multiple-Year Contract*).

⁹Pursuant to the recording statute, 31 U.S.C. § 1501(a)(1), an agency is required to record the full amount of its contractual obligation against funds available at the time a contract is executed, and any authorization to record an obligation for an amount less than the full amount of the government's contractual obligation must be explicit.

accepted accounting principles, or Office of Management and Budget Circular No. A-136, *Financial Reporting Requirements*.

Objectives, Scope, and Methodology

SEC management is responsible for (1) preparing the financial statements of the agency and IPF in conformity with U.S. generally accepted accounting principles; (2) establishing and maintaining effective internal control over financial reporting for both the agency as a whole and IPF, and evaluating its effectiveness; and (3) complying with laws and regulations applicable to both the agency and IPF. SEC management evaluated the effectiveness of internal control over financial reporting as of September 30, 2011, based on the criteria established under FMFIA. Under the Dodd-Frank Act, SEC is also responsible for attesting to the effectiveness of its internal control during the fiscal year.¹⁰

We are responsible for planning and performing the audits of SEC and IPF to obtain reasonable assurance and provide our opinion about whether (1) the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles and (2) SEC management maintained, in all material respects, effective internal control over financial reporting for the agency as a whole and IPF as of September 30, 2011. We are also responsible for (1) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements of SEC and IPF and (2) performing limited procedures with respect to certain other information accompanying the financial statements. Further, under the Dodd-Frank Act, we are responsible for evaluating SEC's assessment of its internal control over financial reporting.¹¹

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by SEC management;

¹⁰ Dodd-Frank Act, Pub. L. No. 111-203, § 963, 124 Stat. 1376, 1910 (July 21, 2010)(codified at 15 U.S.C. § 78d-8).

¹¹ 15 U.S.C. § 78d-8(b)(1).

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- evaluated the overall presentation of the financial statements;
 - obtained an understanding of SEC's and IPF's operations, including SEC's internal control over financial reporting for both the agency as a whole and IPF;
 - considered SEC's process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA;
 - assessed the risk that a material misstatement exists in the financial statements and the risk that a material weakness exists in internal control over financial reporting;
 - evaluated the design and operating effectiveness of internal control over financial reporting based on the assessed risk;
 - tested relevant internal control over financial reporting;
 - evaluated SEC's assessment of its internal control over financial reporting;
 - tested compliance with selected provisions of the following laws and regulations: the Securities Exchange Act of 1934, as amended; the Securities Act of 1933, as amended; the Antideficiency Act; laws governing the pay and allowance system for SEC employees; the Debt Collection Improvement Act; the Prompt Payment Act; the Federal Employees' Retirement System Act of 1986; Full-Year Continuing Appropriations Act, 2011, which incorporates, by reference, certain provisions of the Financial Services and General Government Appropriations Act, 2010; and the Dodd-Frank Wall Street Reform and Consumer Protection Act; and
 - performed such other procedures as we considered necessary in the circumstances.

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss

from unauthorized acquisition, use, or disposition and (2) transactions are executed in accordance with the laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements.

We did not evaluate all internal control relevant to operating objectives as broadly established under FMFIA, such as controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting that are significant to SEC's and IPF's financial statements. Our internal control testing was for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting and may not be sufficient for other purposes. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness. Because of inherent limitations, internal control may not prevent or detect and correct misstatements caused by error or fraud, losses, or noncompliance. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We did not test compliance with all laws and regulations applicable to SEC or IPF. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on SEC's and IPF's financial statements for the fiscal year ended September 30, 2011. We caution that other deficiencies in internal control may exist and not be detected by our tests and that our testing may not be sufficient for other purposes.

We performed our audit in accordance with U.S. generally accepted government auditing standards. We believe our audit provides a reasonable basis for our opinions and other conclusions.

Significant Deficiency over Information Security

In our previous year's audit of SEC, we reported a material weakness in internal control over information systems because of pervasive deficiencies in the design and operation of SEC's information security and other system controls that spanned across its general support system and all key applications that supported financial reporting.¹² During fiscal year 2011, SEC made progress in addressing several of the control deficiencies that comprised this material weakness and thereby strengthened its overall security program. Notable among these efforts were the security

access control improvements and updates SEC made to its core general ledger system, reducing the system's vulnerability to unauthorized access, viruses, attacks, and other threats. SEC also implemented a security monitoring program over its core general ledger system to better identify and address segregation of incompatible duties and an entitywide system security program for its general support system to identify and address security risks. Further, SEC improved its capacity to effectively carry out information security controls through its increased investments in hiring information security staff. However, because SEC's remediation efforts focused primarily on its general ledger system and general support system, we continued to find information security design and implementation deficiencies similar to those found in our previous audit as well as new deficiencies concerning other key financial systems and databases that support financial reporting. These deficiencies decrease assurance regarding the reliability of the data processed by these key financial systems and increase the risk that unauthorized individuals could gain access to critical hardware or software and intentionally or inadvertently access, alter, or delete sensitive data or computer programs. Consequently, the combination of the continuing and new information security deficiencies existing as of September 30, 2011, considered collectively, represent a significant deficiency in SEC's internal control over information security.

Specifically, our fiscal year 2011 testing found that SEC did not perform necessary or adequate information security system updates on its financial system that processes significant amounts of filing fee revenue or its database that houses disgorgement and penalty financial data, thus exposing SEC to information security vulnerabilities in these areas. We also found that for some of its key financial applications, SEC did not always set sufficiently restrictive security-related parameters and users' rights and privileges, effectively secure remote connections, or effectively manage guest user accounts and open ports to prevent unauthorized access to its internal network. SEC also did not always ensure proper security oversight and monitoring of system connections for its information systems that were connected to external systems to ensure the existence of proper security requirements pertaining to these external systems. In addition, SEC did not always adequately protect or secure the confidentiality and integrity of sensitive data transmitted across its internal networks. Further, SEC did not appropriately manage its password

¹² [GAO-11-202](#).

accounts or set system password protections for some of its key financial applications in accordance with its policy, resulting in weak passwords and excessive log-in attempts being allowed before a user's account is suspended.

Additionally, we found that while SEC implemented sufficient security monitoring and auditing tools over its core general ledger system in fiscal year 2011, it did not do so systemically for all of its key system applications that support financial reporting and consequently, it does not yet have comprehensive oversight of, and information concerning, the security risks to financial reporting. Information security risks are further amplified because SEC did not always implement vulnerability and compliance scans on network devices required under its information security program. Until SEC consistently implements all key elements of its information security program systemically across all its financial systems and applications that support financial reporting, there is increased risk that the information that is processed, stored, and transmitted on its systems remain vulnerable, and management will not have sufficient assurance that financial information and financial assets are adequately safeguarded from inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction.

Significant Deficiency over Financial Reporting and Accounting Processes

As we have reported in prior audits, SEC's general ledger system and certain software applications and configurations are not designed to provide the accurate, complete, and timely transaction-level data needed to accumulate and readily report reliable financial information. Instead, the initiation and recording of significant transactions is accomplished through the use of spreadsheets, databases, manual workarounds, and data handling that rely on significant analysis, reconciliation, and review to calculate amounts for the general ledger posting of transactions. These compensating manual processes are resource intensive and prone to error, and coupled with the significant amount of data involved, increase the risk of materially misstated account balances in the general ledger. To address some of the risks in its financial reporting and accounting processes, in fiscal year 2011 SEC implemented a reconciliation control procedure to provide some assurance that the data in its financial reporting tool database that is used to produce its monthly trial balances and financial statements are consistent with the source data in the general ledger. SEC also made enhancements this year to its financial reporting tool that assisted SEC in researching and reviewing financial activity, such as the development of record counts to facilitate comparison of data and

systematic timestamps to ensure the appropriate file is being used. In addition, SEC drafted a policy to strengthen and formalize application and security controls over its spreadsheets and databases (referred to by SEC as user developed applications); however, this policy did not become effective until September 30, 2011. Consequently, SEC operated throughout the fiscal year without adequate controls over some of its user developed applications. Despite SEC's actions to improve controls in this area, errors and deficiencies we found during this year's audit demonstrate that SEC remains at risk of not properly controlling user developed applications and manual financial reporting and accounting processes. Therefore, collectively, these continuing deficiencies represent a significant deficiency in internal control over SEC's financial reporting and accounting processes for fiscal year 2011.

For example, during this year's audit, we found errors in SEC's year-end calculation of its allowance for loss on the disgorgement and penalties receivable because of a spreadsheet formula error that was not discovered by SEC's review process. We also found that SEC made errors in its lease calculations because it used incorrect lease term and rate assumptions and because of spreadsheet formula errors that were also not detected. In addition, we noted that a spreadsheet error resulted in incorrect amounts for SEC's legal liability and lease liability disclosed in the notes to SEC's interim financial statements. SEC made the necessary adjustments to address these errors so that related balances were properly stated at year-end. However, these and other errors we found point to a lack of effective review procedures, which are even more critical given SEC's heavy dependence on spreadsheets and error-prone manual data entry for its financial reporting and accounting processes.

Significant Deficiency over Budgetary Resources

For fiscal year 2011, SEC incurred approximately \$2 billion in new obligations,¹³ which represent legal liabilities against funds available to SEC to pay for goods and services ordered, and deobligated approximately \$39 million for prior year obligations that were either canceled or for which the dollar amount of the obligation was decreased. During this fiscal year, SEC addressed some of the control deficiencies

¹³ In fiscal year 2011, SEC also recorded \$778 million in additional obligations to recognize its full lease obligations pursuant to a GAO legal decision—B-322160, Oct. 3, 2011—concerning SEC's multi-year leasing authority. Refer to note 14 (Status of Budgetary Resources) to the financial statements for a further discussion of this issue.

that we have reported on in the past in this area. A noteworthy action that SEC implemented this year to compensate for a control issue concerning the timeliness of recording deobligations was the implementation of an accounting procedure for estimating an accrual for downward adjustments to obligations in situations where an obligation is no longer valid but has not yet been closed out. This accrual adjustment accounted for \$14.5 million of the total \$39 million in deobligations for fiscal year 2011. SEC also improved procedures this year for deobligating travel obligations and for recording miscellaneous obligations. However, consistent with our findings from our audits of SEC over the past 5 years, this year's audit continued to find general ledger system configuration deficiencies and continuing deficiencies in recording of obligations, monitoring open obligations, and deobligating obligations that were no longer valid. Collectively, these continuing deficiencies represent a significant deficiency in internal control over budgetary resources for fiscal year 2011.

Specifically, because of general ledger system configuration deficiencies that limit SEC from properly posting undelivered order and offsetting collection transactions,¹⁴ SEC recorded \$38 million in manual correcting entries to accurately reflect related account balances on the Statement of Budgetary Resources for fiscal year 2011. Our testing of new obligations during the year also continued to find obligations that were either not supported by sufficient documentation or documentation showing that they were approved by an authorized individual, or were no longer required and therefore should have been deobligated. The errors we found indicated a likely \$12.7 million misstatement in SEC's obligation balance at June 30, 2011. In addition, our fiscal year 2011 testing showed a continuing deficiency in SEC's control over monitoring and reviewing its open obligations to ensure that they remain valid and that adjustments are made properly and timely. Of the 45 recorded deobligations we tested, we found that 28 were not deobligated timely. For example, our work found that SEC's contract close-out process took from 3 months to more than 3 years to complete from the end of the period of performance or completion of the contract. This is largely because SEC does not have a control in place to monitor its contracts in a timely manner, and therefore, needs to carry out time-consuming reconciliation procedures with its vendors before it can

¹⁴Undelivered orders represent obligations incurred for goods or services that have been ordered but not yet received. Offsetting collections are amounts that SEC receives from businesslike transactions with the public (e.g., fees for filing registration statements), which SEC is authorized to credit to its appropriations account for future obligations.

properly adjust an obligation or deobligate an obligation for contracts that were completed or whose period of performance had ended. Deobligating resources timely can be important to an agency to free up resources that may be made available for incurring new obligations or used to provide resources to fund increases to existing obligations.

SEC's new accrual procedure for downward adjustments to open obligations has resulted in more accurate financial reporting of budgetary activity on the Statement of Budgetary Resources for fiscal year 2011. However, the continuing ineffective processes and related documentation deficiencies that caused the errors in budgetary transactions increase SEC's risk of future misstatements being recorded in its general ledger and reported on its Statement of Budgetary Resources.

Significant Deficiency over Registrant Deposits and Filing Fees

SEC is partially funded through the collection of securities registration, tender offer, merger, and other fees (filing fees) from registrants. SEC records the filing fees it collects as revenue. If registrants submit amounts to SEC in excess of the actual fee payment due for a specific filing, SEC records the excess amounts collected in a registrant deposit liability account until earned by SEC from a future filing. Pursuant to a revised SEC policy, SEC is to return to the account holder any funds held in any filing fee account in which there has not been any deposit, withdrawal or other adjustment activity for more than 3 years.¹⁵ We have reported deficiencies in controls over SEC's registrant deposits since fiscal year 2009 and have made recommendations to improve controls over filing fee transactions. This year we noted that SEC made improvements in verifying current filing fee transactions more timely. However, our audit this year found continuing deficiencies in SEC's controls over registrant deposits and filing fees that collectively represent a significant deficiency for fiscal year 2011.

Specifically, SEC has not effectively addressed previously reported deficiencies in its process to enable timely recognition of filing fee revenue. For example, SEC still has not completed its review of dormant registrant

¹⁵In May 2011, for efficiency reasons and to better harmonize with similar rules pertaining to registrant activity, SEC approved an amendment to its account clearing procedures to extend the period in which SEC should hold a registrant's funds in a dormant account from 180 days to 3 years. See SEC regulation at 17 C.F.R. § 202.3a(e) (Return of Funds from Inactive Accounts); see also 76 Fed. Reg. 28,888 (May 19, 2011).

deposit accounts, which consisted of 2,042 accounts totaling over \$12 million as of September 30, 2011, to determine if any of these amounts should be refunded or recognized as revenue. Because of this continuing control deficiency, SEC is not always recognizing filing fee revenue in the correct accounting period and its registrant deposit liability of \$46 million as of September 30, 2011, could be misstated and not be corrected in a timely manner. For example, as of September 30, 2011, SEC identified \$2.3 million in the liability account that should have been recognized as revenue. The change in SEC's policy this year for extending the time period from 180 days to 3 years before initiating a return of funds explains the majority of the reduction in the balance of dormant accounts from \$25.7 million at September 30, 2010, to \$12.5 million at September 30, 2011. However, SEC has made limited progress in researching and determining the proper accounting treatment for the remaining backlog of dormant accounts. SEC has taken some short-term actions to compensate for its lack of timely review. For example, in the fourth quarter of fiscal year 2011, SEC implemented a new procedure to statistically analyze the inactive deposit accounts in order to estimate the amount of unrecognized revenue. This procedure resulted in an estimate of about \$7 million in unrecognized revenue pertaining to the dormant accounts. Contributing to SEC's deficiencies in this area is that SEC has yet to finalize and implement a formal process for ongoing monitoring of filing fee transactions.

Agency Comments

In commenting on a draft of this report, SEC's Chairman expressed her pleasure that GAO found that SEC has successfully remediated the two material weaknesses identified in 2010, and attributes this success to its new leadership team of the Chief Operating Officer, Chief Financial Officer, Chief Information Officer, and Chief Accounting Officer. She stated that SEC will continue working to ensure that its controls infrastructure is strong and sustainable over the long term. The Chairman also commented that SEC will realize improvements in system functionality, automate some manual processes, and further enhance financial management and reporting upon completion in fiscal year 2012 of a migration of its core financial system to a federal government shared service provider. The Chairman added that SEC plans further progress on tightening information security, resolving the backlog of inactive registrant deposit accounts, bolstering controls over budgetary resources, and completing implementation of its new program governing the use of spreadsheets and databases related to financial reporting.

The complete text of SEC's comments is reprinted in its entirety in appendix I.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin". The signature is stylized with a large initial "J" and a long horizontal stroke at the end.

James R. Dalkin
Director
Financial Management and Assurance

November 14, 2011

Management's Discussion and Analysis



MANAGEMENT'S DISCUSSION AND ANALYSIS

The U.S. Securities and Exchange Commission's (SEC) Management's Discussion and Analysis (MD&A) serves as a brief overview of this entire report. It provides a concise description of the agency's performance measures, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned. It also provides an assessment of the SEC's programs and financial performance, and the efficiency and effectiveness of the SEC's operations.

Vision, Mission, Values and Goals

Vision

The SEC strives to promote a market environment that is worthy of the public's trust and characterized by transparency and integrity.

Mission

The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

Values

Integrity	Teamwork
Accountability	Fairness
Effectiveness	Commitment to Excellence

In order to comply with the GPRA Modernization Act of 2010, the SEC is developing an addendum to the fiscal year (FY) 2010 - FY 2015 Strategic Plan. The addendum will reflect the agency's mission, vision, values, and strategic goals through FY 2014, and highlight specific initiatives the agency plans to undertake in the coming 24 months. Additionally, the addendum will include an updated performance measurement framework, as well as updates to existing performance measures that will be used to gauge the agency's progress in accomplishing the strategic goals and outcomes. The addendum will be finalized and available on the SEC's website at <http://www.sec.gov> in February 2012.

Strategic Goals and Outcomes

Goal 1: Foster and enforce compliance with the Federal securities laws

Outcome 1.1: The SEC fosters compliance with the Federal securities laws.

Outcome 1.2: The SEC promptly detects violations of the Federal securities laws.

Outcome 1.3: The SEC prosecutes violations of Federal securities laws and holds violators accountable.

Goal 2: Establish an effective regulatory environment

Outcome 2.1: The SEC establishes and maintains a regulatory environment that promotes high-quality disclosure, financial reporting, and governance, and that prevents abusive practices by registrants, financial intermediaries, and other market participants.

Outcome 2.2: The U.S. capital markets operate in a fair, efficient, transparent, and competitive manner, fostering capital formation and useful innovation.

Outcome 2.3: The SEC adopts and administers rules and regulations that enable market participants to understand clearly their obligations under the securities laws.

Goal 3: Facilitate access to the information investors need to make informed investment decisions

Outcome 3.1: Investors have access to high-quality disclosure materials that are useful to investment decision making.

Outcome 3.2: Agency rulemaking and investor education programs are informed by an understanding of the wide range of investor needs.

Goal 4: Enhance the Commission's performance through effective alignment and management of human, information, and financial capital

Outcome 4.1: The SEC maintains a work environment that attracts, engages, and retains a technically proficient and diverse workforce that can excel and meet the dynamic challenges of market oversight.

Outcome 4.2: The SEC retains a diverse team of world-class leaders who provide motivation and strategic direction to the SEC workforce.

Outcome 4.3: Information within and available to the SEC becomes a Commission-wide shared resource, appropriately protected, that enables a collaborative and knowledge-based working environment.

Outcome 4.4: Resource decisions and operations reflect sound financial and risk management principles.

History and Purpose

During the peak of the Depression, Congress passed the Securities Act of 1933. This law, together with the Securities Exchange Act of 1934 (Exchange Act), which created the SEC, was designed to restore investor confidence in our capital markets by providing investors and the markets with more reliable information and clear rules of honest dealing. The main purposes of these laws were to ensure that:

- Companies publicly offering securities for investment dollars must tell the public the truth about their businesses, the securities they are selling, and the risks involved in investing.
- People who sell and trade securities – brokers, dealers and exchanges – must treat investors fairly and honestly, putting investors' interests first.

The SEC consists of five presidentially appointed Commissioners, with staggered five-year terms. One of them is designated by the President as Chairman of the Commission (see Appendix A: Chairman and Commissioners). President Franklin Delano Roosevelt appointed Joseph P. Kennedy, to serve as the first Chairman of the SEC.

By law, no more than three of the Commissioners may belong to the same political party. The Commission convenes regularly at meetings that are open to the public and the news media unless the discussion pertains to confidential subjects, such as whether to begin an enforcement investigation.

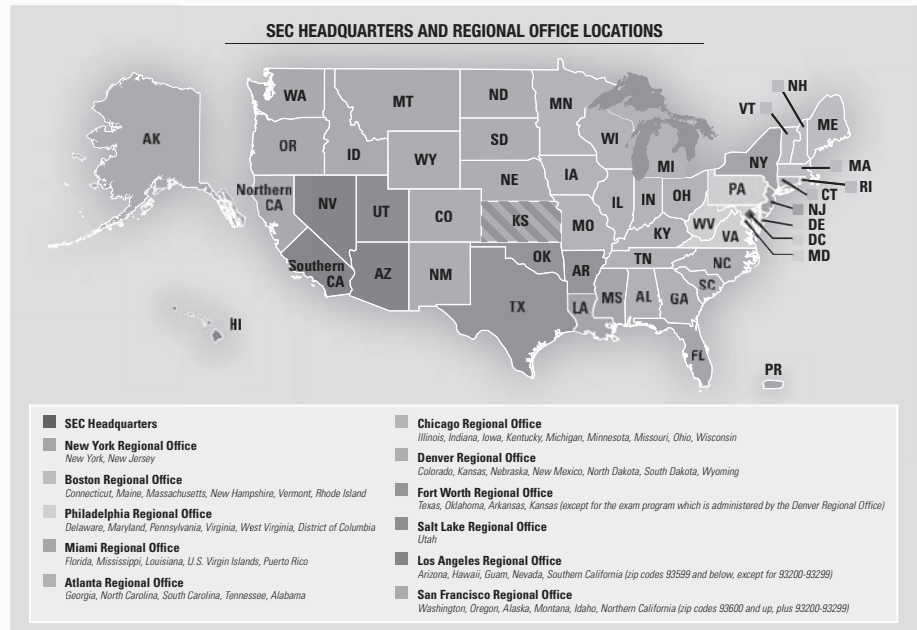
Each year the SEC brings hundreds of civil enforcement actions against individuals and companies for violation of securities laws. Examples of infractions include insider trading, accounting fraud, and providing false or misleading information about securities or the companies that issue them. One of the major sources of information that the SEC relies on to bring enforcement action is investors themselves – another reason that educated and careful investors are so critical to the functioning of efficient markets. To help inform investors, the SEC offers the public a wealth of educational information on its website at <http://www.investor.gov>, as well as an online database of disclosure documents at <http://www.sec.gov/edgar> that public companies and other market participants are required to file with the SEC.

Organizational Structure and Resources

SEC Office Locations

The SEC's headquarters are in Washington, D.C., and it has 11 regional offices located throughout the country. The regional offices are responsible for investigating and litigating potential violations of the securities laws. The offices also have examination staff, who impact regulated entities such as investment advisers, investment companies and broker-dealers. The map below shows the locations of the regional offices, and the states that are included in each region.

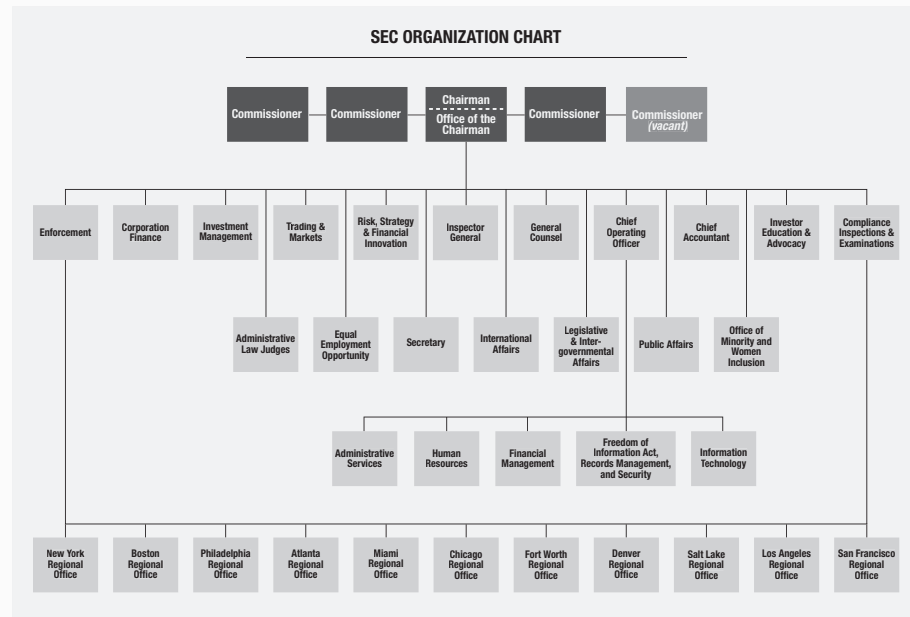
CHART 1.1



SEC Organization Structure

The SEC is an independent Federal agency established pursuant to the Exchange Act. It is headed by a bipartisan five-member Commission, comprised of the Chairman and four Commissioners, who are appointed by the President and confirmed by the Senate (see *Appendix A: Chairman and Commissioners*). The Chairman serves as the Chief Executive Officer. The SEC is organized into five main divisions: Enforcement; Corporation Finance; Investment Management; Trading and Markets; and Risk, Strategy, and Financial Innovation. In FY 2011, the SEC's budgetary authority amounted to \$1,673 million, consisting of an appropriation for salaries and expenses in the amount of \$1,185 million, carryover balances of \$36 million for the expenses of the agency, and \$452 million in the Investor Protection Fund. In FY 2011, the agency employed 3,844 full-time equivalents (FTE), including 3,806 permanent and 38 temporary FTEs. The below SEC organization chart is as of September 30, 2011.

CHART 1.2



MANAGEMENT'S DISCUSSION AND ANALYSIS

SEC Programs

The SEC organizes its divisions and offices under the 10 major programs outlined below in *Table 1.1, SEC Programs and Program Descriptions*.

**TABLE 1.1
SEC PROGRAMS AND PROGRAM DESCRIPTIONS**

Program	Divisions and Offices	Program Descriptions
Enforcement	Division of Enforcement and enforcement staff within the SEC's regional offices	This program investigates and brings civil charges in Federal district court or in administrative proceedings based on violations of the Federal securities laws. An integral part of the program's function is to seek penalties and the disgorgement of ill-gotten gains in order to return funds to harmed investors. Also organized within the Enforcement program is the new Office of the Whistleblower, created to administer the SEC's Whistleblower Program that rewards individuals who provide the agency with tips that lead to successful enforcement actions under the Dodd-Frank Act.
Compliance Inspections and Examinations	Office of Compliance Inspections and Examinations and examinations staff within the SEC's regional offices	This program conducts the SEC's examinations of registrants such as investment advisers, investment companies, broker-dealers, self-regulatory organizations (SROs), credit rating agencies, transfer agents, and clearing agencies.
Corporation Finance	Division of Corporation Finance	This program performs functions to assure that investors have access to materially complete and accurate information, and to deter fraud and misrepresentation in the public offering, trading, voting, and tendering of securities.
Trading and Markets	Division of Trading and Markets	This program conducts activities to establish and maintain standards for fair, orderly and efficient markets, while fostering investor protection and confidence in the markets.
Investment Management	Division of Investment Management	This program seeks to minimize the financial risks to investors from fraud, mismanagement, self-dealing, and misleading or incomplete disclosure in the investment company and investment adviser segments of the financial services industry.
Risk, Strategy, and Financial Innovation	Division of Risk, Strategy, and Financial Innovation	The division provides economic analyses as part of Commission's rulemaking process; supports its rule review, examination and enforcement programs with data-driven, risk-based analytical methods; and oversees its Tips, Complaints and Referrals (TCR) and interactive data programs.
General Counsel	Office of the General Counsel	The Office of the General Counsel (OGC) serves as the chief legal officer of the Commission and provides independent legal analysis and advice to the Chairman, Commissioners, and operating divisions on all aspects of the Commission's activities. The General Counsel also defends the Commission in Federal district courts, represents the Commission in all appellate matters and <i>amicus curiae</i> filings, and oversees the SEC's bankruptcy program.
Other Program Offices	<ul style="list-style-type: none"> • Office of the Chief Accountant; • Office of Investor Education and Advocacy; • Office of International Affairs; and • Office of Administrative Law Judges 	These offices are responsible for: <ul style="list-style-type: none"> • serving as the chief advisor to the Commission on all accounting and auditing policy and overseeing private sector standards setting; • serving investors who contact the SEC, ensuring that retail investors' perspectives inform the Commission's regulatory policies and disclosure program, and improving investors' financial literacy; • advancing international regulatory and enforcement cooperation, promoting converged high regulatory standards worldwide, and facilitating technical assistance programs in foreign countries; and • adjudicating allegations of securities law violations.

(Continued on next page)

Management's Discussion and Analysis

TABLE 1.1 Continued from previous page

Program	Divisions and Offices	Program Descriptions
Agency Direction and Administrative Support	<ul style="list-style-type: none"> • The Chairman and Commission; • Office of Legislative and Intergovernmental Affairs; • Office of Public Affairs; • Office of the Secretary; • Office of the Chief Operating Officer; • Office of Information Technology; • Office of Freedom of Information Act, Records Management, and Security; • Office of Financial Management; • Office of the Executive Director¹; • Office of Human Resources; • Office of Administrative Services; • Office of Equal Employment Opportunity; and • Office of Minority and Women Inclusion 	<p>The Chairman is responsible for overseeing all aspects of agency operations, and the Chairman and Commissioners are responsible for the review and approval of enforcement cases and formal orders of investigation and the development, consideration, and execution of policies and rules. The other offices in Agency Direction and Administrative Support are responsible for:</p> <ul style="list-style-type: none"> • working with Members of Congress on issues that affect the Commission; • coordinating the SEC's communications with the media, the general public, and foreign visitors; • reviewing all documents issued by the Commission, and preparing and maintaining records of Commission actions; • maximizing the use of SEC resources by overseeing the strategic planning, information technology, financial management, records management, human resources, and administrative functions of the agency; • ensuring that the SEC is an equal opportunity employer in full compliance with all Federal equal employment opportunity laws; and • enhancing the diversity of the SEC's workforce, contractors, and regulated entities in accordance with existing Federal laws and regulations.
Inspector General	Office of Inspector General	The Office of Inspector General (OIG) is an independent office that conducts audits of programs and operations of the SEC and investigations into allegations of misconduct by staff or contractors. The mission of OIG is to detect fraud, waste, and abuse and to promote integrity, economy, efficiency, and effectiveness in the SEC's programs and operations.

As shown in the *Statement of Net Cost*, on page 123, the SEC presents its net costs of operations by the programs outlined above, consistent with the presentation used by the agency in submitting its budget requests. A detailed discussion of program achievements and program contributions to accomplishing the mission of the SEC can be found in the *Performance Section*.

¹ The Office of the Executive Director was eliminated in FY 2011, but the costs of the Office during the early months of the fiscal year are included under Agency Direction and Administrative Support. The Office of the Executive Director was responsible for management of the agency's human resources, budget management, and administrative services functions. When the Office was eliminated, these functions were transferred under the Office of the Chief Operating Officer.

FY 2011 Year in Review

A More Modern and Effective SEC

In fiscal year 2011, the U.S. Securities and Exchange Commission continued to improve its effectiveness in pursuit of its investor protection and market integrity missions. This progress was the result of an ongoing, comprehensive effort to improve basic agency functions and organization; align regulation, enforcement and oversight strategies and priorities with evolving financial market conditions; and equip the SEC's 3,800 professionals with the tools and training required to perform at the highest level.

Institutional enhancements begun two years ago continued to bear fruit, as a changing culture increased the capacity and improved the performance of the SEC. New hiring and training strategies lifted staff performance while the creation of specialized teams in the enforcement and examination programs helped the agency increase in-house expertise in those areas. Reorganization of key divisions and offices and an increased emphasis on collaboration and intra-agency communication made the SEC more creative and responsive.

Core functions, including examination and enforcement, benefitted from new and upgraded information systems which allowed staff to focus resources on high-risk registrants and to discover suspicious conduct more rapidly. Other divisions and offices looked beyond traditional priorities to identify emerging threats and opportunities within the financial markets, adjusting strategies and priorities to better protect investors and markets in a rapidly-changing environment.

Recognizing the historic significance of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the SEC supported its many Dodd-Frank Act-related rulemakings with aggressive efforts to solicit and consider ideas and criticisms from market participants of all types, and to align action with domestic and foreign regulators (with whom the SEC must coordinate policy in order to limit exploitable regulatory inconsistencies).

And the SEC continued to upgrade human resources and back office functions, improving resource allocation, increasing the value of the SEC's human capital, and allowing

staff to focus on the SEC's investor protection and market stability mission – all while capturing savings through further efficiencies in administrative tasks.

It should be noted, however, that savings and efficiencies alone will not free up sufficient resources to allow the SEC to effectively carry out a mission that is expanding significantly as a result of the Dodd-Frank Act.

The SEC is better positioned today than it has been in many years to respond quickly to events and developments in the financial world; to keep regulatory pace with the continuing evolution of the financial markets; and to deter, identify, and pursue wrongdoers. It is important that the agency's funding increases in step with these increasing responsibilities, in order to ensure that investors and markets continue to benefit from the SEC's improving performance.

Enforcement: A Record Performance

A reorganized Division of Enforcement is collaborating more closely than ever with other SEC offices and increasingly utilizing technology as a way to identify and halt unlawful activity before it occurs or results in additional investor harm. The Division's aggressive strategy sends a clear message that securities law violations will be discovered and punished.

Enforcement's broad focus has meant successful actions against a wide range of unlawful conduct, ranging from fraud committed by large financial institutions whose actions contributed to the financial crisis – including Countrywide Financial, J.P. Morgan, and Wachovia – to smaller frauds that did not generate headlines but nonetheless threatened the savings of vulnerable individuals.

Having completed the most significant restructuring since its establishment almost 40 years ago, Enforcement continued to enhance its effectiveness by focusing resources on the misconduct that most harms investors and markets, by developing risk-based initiatives that anticipate suspicious behavior before a fraud takes hold, and by using the agency's new IT resources to create analytical tools and to process the increasing amounts of data that accompany its investigations.

The Division of Enforcement has built closer ties with the Office of Compliance Inspections and Examinations (OCIE), as well. And, the Division is developing specialized skills and new approaches for investigating possible violations in key areas such as valuation, aberrational performance by hedge funds and investment advisers, and microcap fraud.

These changes have allowed Enforcement to move faster and more strategically to attack securities laws violations, and to achieve record results in the process.

The SEC brought 735 enforcement actions in FY 2011, more than have ever been filed by the Commission in a fiscal year. Eighty-five of those actions were designated National Priority Cases – the Division's most important and complex. In addition to the improvement in the quantity and quality of the filed enforcement actions, the Division obtained orders for \$2.8 billion in penalties and disgorgement; utilized enhanced remedies available under the Dodd-Frank Act to bar numerous wrongdoers from future work in the securities industry; and obtained relief that sent a strong deterrent message, including asset freezes, trading suspensions, and penny stock bars.

A fuller description of Division of Enforcement actions filed in FY 2011 can be found in *Appendix B: Major Enforcement Cases*, but this brief survey conveys the breadth and effectiveness of those efforts:

Financial Crisis

Since 2008, the SEC has filed 36 actions against 81 individual and corporate defendants alleging a wide range of misconduct arising from the financial crisis. Fifteen of these actions were filed in 2011, up from 12 filed in 2010.

- Among the most significant of these actions was that filed against J.P. Morgan Securities, LLC, for misleading investors in a complex mortgage securities transaction executed just as the housing market was starting to plummet. The SEC charged J.P. Morgan for structuring and marketing a synthetic collateralized debt obligation (CDO) without informing investors that a hedge fund helped select the assets in the CDO portfolio and that the fund had a short position in more than half of those assets. J.P. Morgan settled the SEC's charges by paying \$153.6 million, which represented a full return of losses



to harmed investors. J.P. Morgan also agreed to improve its processes for the review and approval of mortgage securities transactions and to return more than \$56 million to investors who were harmed in a second CDO transaction.

- Countrywide Financial Chief Executive Officer (CEO) Angelo Mozilo agreed to pay a record \$22.5 million penalty to settle SEC charges that he and two other former Countrywide executives failed to disclose to investors the significant credit risk that Countrywide was taking on as it increased its share of the subprime mortgage market. Mozilo was permanently barred from serving as an officer or director of a publicly-traded company and agreed to disgorge \$45 million in ill-gotten gains. A total of \$67.5 million is being returned to harmed investors.
- The SEC settled charges filed previously against Morgan Keegan & Company and Morgan Asset Management, which agreed to pay \$200 million to settle fraud charges. Two Morgan Keegan employees also agreed to pay penalties for their alleged misconduct, including one who is now barred from the securities industry. The Memphis-

MANAGEMENT'S DISCUSSION AND ANALYSIS

based firms, former portfolio manager James C. Kelsoe Jr. and comptroller Joseph Thompson Weller were accused by the SEC of causing the false valuation of subprime mortgage-backed securities in five funds managed by Morgan Asset Management, from January 2007 to July 2007. The SEC's order issued in settling the charges also found that Morgan Keegan failed to employ reasonable pricing procedures and consequently did not calculate accurate "net asset values" (NAV) for the funds. Morgan Keegan nevertheless published the inaccurate daily NAVs and sold shares to investors based on the inflated prices.

- In separate actions, the SEC charged RBC Capital Markets LLC and brokerage firm Stifel, Nicolaus & Co. with defrauding five Wisconsin school districts by selling them unsuitably risky and complex CDO investments. Stifel and former Stifel Senior Vice President David W. Noack were charged with misrepresenting the risk of the investments and failing to disclose material facts to the school districts. The sales took place despite significant concerns within RBC Capital about the suitability of the product for municipalities like the school districts. RBC Capital agreed to settle the SEC's charges by paying a total of \$30.4 million, which will be distributed in varying amounts to the harmed school districts through a Fair Fund. The SEC's case against Stifel, Nicolaus & Co. is continuing.
- The SEC charged Wells Fargo Securities LLC – formerly known as Wachovia Capital Markets LLC – with misconduct by Wachovia in the sale of two CDOs tied to the performance of residential mortgage-backed securities as the housing market was beginning to show signs of distress. The SEC's order found that Wachovia violated securities laws by charging undisclosed excessive markups in the sale of certain interests to investors in one CDO, and by misrepresenting to investors in another CDO the value at which it had acquired assets from affiliates. In settling the action, Wells Fargo agreed to pay more than \$11 million in disgorgement and penalties, most of which will be returned to harmed investors.

Fraudulent Schemes

Supporting investor confidence in the financial markets means bringing cases not only against major financial firms and their executives, but also against individuals and smaller firms whose misdeeds can steal a lifetime's savings or devastate an investor's future.

- The SEC charged three senior executives at the Akron, Ohio-based Fair Finance Company with orchestrating a \$230 million fraudulent scheme involving at least 5,200 investors – many of them elderly. The SEC alleges that after purchasing Fair Finance Company, Chief Executive Officer Timothy S. Durham, Chairman James F. Cochran, and Chief Financial Officer Rick D. Snow deceived investors, selling interest-bearing certificates whose proceeds were supposed to be used to purchase and service discounted consumer finance contracts. Instead, Durham and Cochran schemed to divert investor proceeds to themselves and others, as well as to struggling and unprofitable entities that they controlled.
- The SEC charged internet-based investment company Imperia Invest IBC with securities fraud and obtained an emergency court order freezing Imperia's assets. The SEC alleged that Imperia solicited several million dollars from U.S. investors and promised them returns of 1.2 percent per day – while in reality siphoning the funds into foreign bank accounts and not paying a single penny back. Imperia allegedly raised more than \$7 million from approximately 14,000 investors worldwide. More than half the funds were collected from U.S. investors who are members of the Deaf community.

Insider Trading

The Commission has aggressively pursued practices that damage the integrity of financial markets and discourage investors who seek a fair and level playing field. Most notably, the SEC discovered and developed information that ultimately led to criminal convictions for Galleon hedge fund founder Raj Rajaratnam and others, and to Commission charges against 22 individuals – including high-ranking corporate executives and hedge fund managers – and against seven entities involved in the scheme (in November 2011, Rajaratnam was ordered to pay a record \$92.8 million to resolve SEC charges in the case).

There have been other important cases, as well.

- The SEC charged a former Mariner Energy Inc. board member and his son with insider trading on confidential information about an impending takeover of the oil and gas company. Acting on a tip from his father, H. Clayton Peterson, son Drew Clayton Peterson purchased Mariner Energy stock for himself, his relatives, his clients and a close friend in advance of an announcement that Apache Corporation would be acquiring Mariner. Peterson also tipped several other close friends, who traded on the nonpublic information ahead of the April 2010 acquisition announcement. The insider trading by the Petersons and others generated more than \$5.2 million in illicit profits.
- The SEC charged former Nasdaq managing director Donald L. Johnson with insider trading on confidential information he stole while working in two units at Nasdaq that communicated with companies in advance of market-moving public announcements. The SEC alleged that Johnson used the stolen information to trade in the stock of six companies on at least nine occasions, realizing illicit profits of more than \$755,000.
- The SEC charged Cheng Yi Liang, a chemist at the U.S. Food and Drug Administration (FDA), with insider trading on confidential information concerning upcoming announcements of FDA drug approval decisions, generating more than \$3.6 million in illicit profits and avoided losses. Liang illegally traded in advance of 28 public announcements about FDA drug approval decisions, involving 20 publicly-traded companies, for profits and losses avoided totaling over \$3.7 million. In each instance, Liang traded in the same direction as the announcement. Liang went to great lengths to conceal his insider trading, including trading in multiple accounts, none of which were in his name.

Municipal Securities

The SEC focused increased attention on the lightly-regulated municipal securities market, in which well-connected individuals and firms use influence and collusion to win lucrative fund management contracts or otherwise short-change the municipalities whose interests they are supposed to be serving.

- In a series of cases, the SEC charged J.P. Morgan Securities LLC, UBS Financial Services Inc., and Banc of America Securities, LLC with rigging more than 200 municipal bond re-investment transactions, generating tens of millions of dollars in ill-gotten gains. Together, the settlements of these three cases resulted in the return of \$134 million to harmed municipalities and conduit borrowers in more than 40 states. In addition, the companies paid a total of \$391 million to settle parallel cases brought by other Federal and state authorities.

Misleading Investors

The SEC continued its vigilant enforcement of regulations regarding entities such as mutual funds, investment advisers, and broker-dealers who are entrusted with a significant portion of the investing public's assets.

- The Commission charged Charles Schwab Investment Management and Charles Schwab & Co. Inc. with making misleading statements about the Schwab YieldPlus Fund – at one time, the largest ultra-short bond fund. The misleading statements included descriptions of the fund as a cash alternative that offered only slightly higher risk than a money market fund. The fund suffered a significant decline during the credit crisis of 2007 and 2008. The Schwab entities agreed to pay more than \$118 million to settle the SEC's charges. The SEC also charged the responsible Schwab executives, who are currently litigating the SEC's claims.

OCIE Referrals

Increased cooperation with OCIE, which collaborates with Enforcement when its examinations reveal suspicious activity, resulted in several important cases, including the Stifel, Nicolaus & Co case described above.

- Three AXA Rosenberg entities, as well as the co-founder of the firm, Barr Rosenberg, were charged with securities fraud for concealing a significant error in the computer code of the quantitative investment model that they developed and used to manage client assets. AXA Rosenberg agreed to settle the SEC charges by paying \$217 million to cover investor losses, to pay an additional \$25 million penalty and to take other remedial

MANAGEMENT'S DISCUSSION AND ANALYSIS

steps. Separately, Barr Rosenberg agreed to settle the SEC's charges by paying a \$2.5 million penalty and agreeing to be barred from the securities industry.

- The SEC filed an emergency action and obtained emergency relief to halt a multi-million dollar misappropriation of investor assets by registered investment adviser MK Capital Management, LLC and its principal, Francisco Ilarramendi. The Commission subsequently amended its complaint to allege that Ilarramendi and MK Capital had misappropriated investor assets and misused two hedge funds they managed in a Ponzi scheme involving hundreds of millions of dollars. The SEC obtained a court order freezing the assets of the hedge funds and ordered that all assets of the hedge funds, including \$230 million held in offshore accounts, be repatriated to the United States. Ilarramendi was permanently barred by the SEC from serving in the securities industry.

The Division of Enforcement's 2011 performance reinforces what a growing number of individuals and entities are discovering: recent improvements in the Division's structure, expertise, management, technology, and staff capacity are allowing the Commission not only to bring more – and more complex – cases, but to obtain better results on investors' behalf.

OCIE: Protecting Investors through More Effective Examinations

In 2011, OCIE significantly expanded its ability to contribute to the SEC's mission – improving its ability to identify risk and target examinations and resources accordingly, changing structure to more effectively acquire and deploy expertise, and collaborating across the agency to improve both the examination and the rulemaking processes. OCIE's National Exam Program (NEP) anchored this improving performance by weaving a number of key initiatives into a single effective effort.

Collaboration with the Division of Risk, Strategy and Financial Innovation (RSFI) allows the NEP to continuously improve its targeting and risk indicators and to focus exams on registrants that are most likely to merit them. A recently-established Office of Risk Analysis and Surveillance within OCIE guides that targeting strategy across different program areas and

sharpens focus on registrants and practices that pose the greatest risk to investors and market integrity.

As part of its risk assessment efforts, OCIE began developing risk profiles of systemically relevant institutions, including large broker-dealers, clearing agencies and exchanges. OCIE has completed risk profiles of each of the 21 national securities exchanges and self regulatory organizations (SROs), enabling NEP to understand individual risk, and risk among the exchanges as a group. OCIE has audited all ten nationally recognized statistical rating organizations, and publicly reported the findings. OCIE has begun risk-monitoring of clearing agencies and it is moving to develop risk profiles of the largest and most systemically significant broker-dealers.

Continuing improvements in risk-based targeting allow the NEP to extend resources and staffing strained by the continued growth in the number and complexity of the registrants OCIE is charged with examining. Further, specialized groups now focus on complex and high-risk areas of the financial marketplace.

OCIE also is working to extend its capacity by establishing an infrastructure that reflects the SEC's increasingly diverse registrant population, including private fund advisers, credit rating agencies, and quantitative/high-frequency trading advisers.

A major restructuring is underway within OCIE, including the development of specialized working groups (SWGs) in six key areas and over thirty other significant improvement initiatives. The SWGs will serve as forums in which the NEP and other agency staff can collaborate and discuss current issues, initiatives, and concerns related to each specialized area. They will serve as an ongoing resource for training and for disseminating this specialized knowledge, as well.

OCIE is hiring exam staff with industry experience and specialized expertise in targeted areas, and enhancing the resources and tools available to examination staff. These efforts also include new training: OCIE has worked with SEC University to develop targeted training in areas like risk management and on specific topics related to new responsibilities created by the Dodd-Frank Act, such as examining private fund advisers. Development of a new certified examiner program is underway, as well.

The examination process itself has been improved. Once examination targets are identified, an open architecture staffing system allows the NEP to assemble more effective teams by bringing together different combinations of individuals, with varying areas of expertise, to address the unique challenges each examination presents.

OCIE is increasingly collaborating with other organizations, inside and outside the SEC, to improve the quality of examinations and of disclosures made by registered entities. The Office is reaching out to state regulators, local and national law enforcement agencies and – where appropriate – foreign regulators, sharing information and examinations strategies.

Within the SEC, OCIE is collaborating with the Division of Trading and Markets (TM) on examinations of broker-dealers, SROs, and transfer agents. This allows OCIE to identify important areas of focus and has led to TM requests that firms change certain practices. OCIE also teams with the Division of Investment Management (IM) for examinations of various investment funds and their management, collaborating on reviews of money market fund filings and using data provided by IM in its risk assessment of registrants.

Key OCIE actions that led to Division of Enforcement action include:

- Identifying the sale of millions of dollars of micro-cap securities through false and misleading statements, followed by swift action to protect investors' assets, including freezes, trading halts and/or fines. The micro-cap review demonstrates the benefits of OCIE's recently-created specialized groups, one of which focuses on these securities.
- Discovering that a broker was churning two accounts owned by the Sisters of Charity – one account for care of nuns in assisted living facilities and a second supporting the sisters' charitable endeavors – in order to generate excess commissions for the broker.
- Identifying information that led to the charging of Raymond James with misrepresenting and omitting material information in connection with the sale to customers of over \$2.4 billion in market value of auction rate securities.



OCIE's effort to promote voluntary compliance, good governance and risk management within the industry serves both investors and registrants: it diminishes the need for formal action while ensuring that investors have access to accurate, timely information. As part of this effort, OCIE has conducted Chief Compliance Officer Outreach (CCOutreach) events designed to encourage open communications and coordination on compliance issues between the SEC and the mutual fund, investment adviser, and broker-dealer industries. OCIE published two public reports as part of a new initiative to create more transparency about issues identified in its examinations. Additionally, OCIE created an expansive large-firm monitoring program and improved communication efforts with senior management and fund boards at a number of large organizations. A primary goal of these efforts is to increase awareness, engagement and support on key risk and regulatory issues.

Finally, OCIE is contributing to the SEC's rulemaking process, imparting practical knowledge and information gathered during examinations while taking part in over 50 working groups implementing various Dodd-Frank Act rulemaking provisions. Other rulemakings have benefitted from significant OCIE input, as well, including large trader reporting rules, amendments to the Advisers Act and the consolidated audit trail rule proposal.

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**Operating Divisions:
Progress throughout the Agency**

Enforcement, examination and rulemaking are the SEC's most visible functions. However, the importance of other efforts cannot be overstated. The SEC ensures that investors have access to timely, accurate and complete information, that markets function efficiently, that regulations are anchored in sound economics and that the agency as a whole is keeping up with changes in the financial marketplace.

The **Division of Corporation Finance** (CF), which oversees corporate disclosure of information, established new offices concerned with three vital facets of the financial world: an office focused on the largest financial institutions; the Office of Structured Finance, which deals with disclosure reviews and policy-making in asset-backed securities and other structured products; and the Office of Capital Market Trends. These offices are increasing the attention paid to market sectors that have proved systemically significant in recent years, aiding rulemaking and improving the SEC's familiarity with and expertise in these increasingly important areas.

CF's Office of Disclosure Operations worked in 2011 to enhance investor protection by targeting specific disclosure issues that had previously received little attention: requesting disclosure of overseas cash holdings which, if repatriated, would result in material, negative consequences; questioning whether current litigation contingency disclosure practices comply with existing requirements; and working with Enforcement, the Office of the Chief Accountant (OCA) and the Office of International Affairs (OIA) to combat an uptick in problems with reverse mergers by stepping up scrutiny of the Form 8-Ks filed in their wake.

In support of the SEC's call to facilitate capital formation for small enterprises, CF also began reviewing restrictions on communications in public offerings, the impact of the ban on general solicitation in private offerings, triggers for public reporting under Section 12(g) of the Exchange Act and regulatory questions around subjects including secondary trading platforms and new capital raising strategies.

In addition to very significant rulemaking responsibilities regarding derivatives trading, the **Division of Trading and**

Markets (TM) addressed a broad spectrum of issues as it worked to help stabilize the financial markets and protect the interests of large and retail investors.

TM received and processed over 2,000 SRO filings from exchanges, clearing agencies, the Financial Industry Regulatory Authority (FINRA), and the Municipal Securities Rule-making Board (MSRB), including those regarding complex fee structures, new products, and revamped governance structures. TM led Commission monitoring of – and, as appropriate, response to – market activities in connection with significant events, including Hurricane Irene and the August 2011 market volatility, helping markets continue to function normally despite significant stress.

TM also continued to solicit stakeholder views on the structure of today's financial markets and on potential changes that might improve market integrity or help maintain a level playing field for investors of all types.

TM established a new Office of Derivatives Policy to focus on implementing the derivatives provisions of the Dodd-Frank Act. TM also continued to expand the clearance and settlement program, an effort that culminated in the establishment of a new Office of Clearance and Settlement. Traditionally focused on securities clearing agencies and transfer agents, the Office of Clearance and Settlement is now also responsible for implementing Dodd-Frank Act regulations for clearing agencies that clear security-based swaps, and for overseeing security-based swap data repositories.

The Dodd-Frank Act expanded the SEC's regulatory authority over previously-exempted advisers to hedge funds and other private funds, an important expansion of agency responsibility. The **Division of Investment Management** (IM) formed a new Private Funds group headed by an experienced hedge fund attorney to spearhead this regulatory program and to gear up for the task of collecting and conveying information that will be reported to the SEC by these entities for use by the Financial Stability Oversight Council (FSOC).

IM also worked with FSOC members to share information newly filed by money market funds with the SEC and the related analyses. This has facilitated critical consultations with other agencies responsible for monitoring systemic risk related to the European debt crisis.

The **Division of Risk, Strategy, and Financial Innovation** (RSFI) was created in 2009 as the SEC's internal "think tank," and provides the agency with sophisticated analyses that integrate economic, financial, and legal expertise. A linchpin of the SEC's effort to break down silos and bring together critical data from across the agency, RSFI is the "business owner" of the SEC's new TCR (tips, complaints and referrals) System, generating data and statistics on the system's operations and helping to define further system development.

RSFI provided critical support in the successful federal insider trading prosecutions of Raj Rajaratnam and Winifred Jiau, analyzing expert testimony and other documents proffered by the defense and allowing prosecutors to successfully challenge key portions of the defense's strategies.

The Division has contributed substantially to the Dodd-Frank Act rulemaking process, particularly with regard to the over-the-counter derivatives market. And RSFI is at the center of the SEC's work to provide detailed economic analysis of proposed agency actions.

RSFI also worked closely with OCIE, refining risk models that help OCIE direct exam resources in light of current trends and suspected abuses, and it participated in exams as part of RSFI's work developing tools, algorithms, and analytics that enhance the effectiveness of field teams at these exams.

Consistent with its "think tank" role, RSFI economists conducted research on financial and economic issues relevant to the SEC's mission, for publication in peer-reviewed academic journals, on relevant subjects such as "Short Selling in Initial Public Offerings" and "Venture Capital Reputation, Post-IPO Performance, and Corporate Governance."

The **Office of the Chief Accountant** (OCA) continued to coordinate and monitor progress towards convergence of U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards (IFRS). OCA published both a report on progress against the staff's IFRS work plan and a Staff Paper exploring a possible method for incorporation of IFRS. OCA also worked with the SEC's **Office of International Affairs** (OIA) to develop recommendations and a final report regarding the IFRS Monitoring Board Governance Review.

In connection with OCA's role in overseeing the Public Company Accounting Oversight Board (PCAOB), the SEC approved a PCAOB rulemaking to update its Audit Risk Assessment Standards. These standards are designed to benefit investors by enhancing the effectiveness of the auditor's assessment of and response to the risks of material misstatement.

The SEC also approved temporary rules establishing the PCAOB's Interim Program of Inspection for Audits of Broker-Dealers. These rules are part of the PCAOB's initial steps to implement the expanded authority over auditors of broker-dealers granted it in the Dodd-Frank Act.

Since the Commission's appointment of three new PCAOB Board Members in February, 2011, OCA has been working closely with the new Board and PCAOB staff on several Board initiatives, including its consideration of potential changes to the auditors' reporting model.

OCA is also working with the PCAOB and the SEC's OIA on continuing negotiations with certain jurisdictions – most notably in the European Union and China – aimed at obtaining for the PCAOB the ability to adequately inspect audits by registrants' accountants. These negotiations occur at a time when the reliability of financial reports and audit practices in some jurisdictions has been called into question, leading to investor losses and the de-listing of a number of entities.

In addition to its work with OCA, OIA is working closely with Enforcement to ensure that the SEC's reach is as global as the financial markets have become – tracing and freezing \$317 million of fraud proceeds located overseas and repatriating \$241 million to harmed investors. It helped coordinate more than one thousand assistance requests between Enforcement and its foreign counterparts, while working to increase – from 71 nations to 80 – the number of signatories to a memorandum of understanding regarding compliance with and enforcement of securities laws. In addition, OIA brokered information-sharing agreements between the PCAOB and the United Kingdom and the Swiss Audit Oversight Authorities, allowing the PCAOB to inspect the auditors of foreign companies listed on U.S. exchanges and registered with the SEC.

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OIA also created and led a Task Force on International Implementation – an intra-agency task force coordinating the international aspects of the Dodd-Frank Act. The Task Force's work is diminishing the risk that Dodd-Frank Act regulation will conflict with regulations in other countries, and create the potential for regulatory arbitrage.

The **Office of Investor Education and Advocacy (OIEA)** redesigned and expanded its investor.gov website, adding information on a variety of topics, and materials aimed at the particular needs of specific groups, such as service members, teachers and retirees. OIEA completed a Dodd-Frank Act study on ways to improve investors' access to registration information about investment professionals. In addition, it began a multi-part study on financial literacy among retail investors underway.

**A Critical Market Response:
May 6th and Market Confidence**

In 2011, the SEC continued efforts to address the unusual market volatility that occurred on May 6, 2010.

At 2:42 on the afternoon of May 6, 2010, stock prices on U.S. exchanges began to fall with almost unprecedented speed – 573 points in five minutes – leaving the nation's most prominent stock index down over 900 points from the previous day's close. At the worst end of the spectrum, more than 300 securities suffered declines of more than 60 percent. And then, just as suddenly, the markets reversed themselves, recovering to pre-crash levels within minutes.

These unusual price swings caused significant harm to many investors, including those who lost money when “stop loss” programs led to automatic selling during the dramatic – but quickly reversed – decline. In addition to financial losses, the sudden disruptions also delivered a significant blow to the confidence of investors of all types – individual retail investors, large institutions and all those in between.

Recognizing the significance of the market's unusual fluctuations, the SEC acted immediately, working with the exchanges, FINRA and the Commodity Futures Trading Commission (CFTC) to determine causes of the volatility and to take action to reduce the possibility of other, similar, events occurring in the future.

Beginning in May 2010, the SEC – spearheaded by the Division of Trading and Markets – joined with FINRA and the exchanges to propose the single-stock circuit breakers which would ultimately be applied to most U.S. equity securities.

On October 1, 2010, staffs of the SEC and CFTC presented a comprehensive analysis of the causes and consequence of the May 6 volatility, as the SEC's efforts to enhance market integrity continued into the new fiscal year.

- In 2011, the SEC adopted a rule effectively prohibiting brokers and dealers from offering customers “unfiltered” or “naked” access to the exchanges by requiring that risk controls – designed to prevent inadvertent risk threats to market stability – be in place before access is provided. The rule requires brokers to put in place risk management controls and supervisory procedures to help prevent erroneous orders, ensure compliance with regulatory requirements, and enforce pre-set credit or capital thresholds.
- The SEC approved rules proposed by FINRA and the exchanges that provide more certainty regarding the circumstances under which trades will be considered “clearly erroneous” and canceled. After May 6, a variety of market participants reported that the uncertainty over which trades would be canceled contributed to participants' decision to withdraw from trading, further exacerbating the market's volatility.
- The SEC also approved rules proposed by FINRA and the exchanges requiring that market makers maintain a

quote within a certain percentage of the prevailing bid and offer, which reduces the likelihood that stub quotes – offers to buy or sell a stock at a price so far away from the prevailing market that they are not intended to be executed – will be executed against. Executions against quotes as low as a penny a share and as high as \$100,000 represented a significant proportion of the trades that were executed at extreme prices on May 6 and were subsequently broken.

- The SEC considered a proposed national market system (NMS) plan filed by national securities exchanges and FINRA that would establish a new “limit up-limit down” mechanism to address extraordinary market volatility in U.S. equity markets. Limit up-limit down would prevent trades in listed equity securities from occurring outside a specified price band, which would be set at a percentage level above and below the average price of the security over the immediately preceding five-minute period.
- The Commission published for comment changes proposed by SROs to rules governing market-wide circuit breakers. Among other things, the proposals would lower the thresholds that trigger the respective Level 1, 2 and 3 market-wide circuit breakers from 10 percent, 20 percent and 30 percent, to 7 percent, 13 percent and 20 percent. They also would replace the Dow Jones Industrial Average with the S&P 500 Index as the pricing reference against which to measure market decline.
- The Commission adopted a rule establishing large trader reporting requirements that will enhance the agency’s ability to identify large market participants, as well as to collect and analyze information on their trading activity. This will both speed analysis of unexpected market behavior and aid the SEC’s Division of Enforcement in investigations of suspicious activity.

Dodd-Frank Act Regulations: Implementing Financial Reform

The Dodd-Frank Act is the most significant piece of securities legislation since the 1930s, one that both imposes significant new investor protection and market stability responsibilities on the SEC, and provides new tools with which to meet those responsibilities. 2011 was the busiest portion of the multi-

year implementation agenda written by Congress into the law and the SEC – in collaboration with other regulatory bodies and in close communication with stakeholders representing every facet of the financial marketplace – made significant progress against that agenda.

Of the more than 90 mandatory rulemaking provisions in the Dodd-Frank Act, the SEC had proposed or adopted rules for three-quarters of them by the close of 2011, as well as a number of the rules stemming from the dozens of other provisions that give the SEC discretionary rulemaking authority. Additionally, the SEC had issued 12 of the more than 20 studies and reports that it is required to complete under the Act.

Derivatives

One of the most complex and important responsibilities assigned to the SEC in the Dodd-Frank Act is the building – from the ground up, together with the Commodity Futures Trading Commission (CFTC) – a regulatory system for an over-the-counter derivatives market that has grown in notional value to hundreds of trillions of dollars. A new, transparent derivatives market, with a variety of trading platforms and central clearing, will diminish risk and encourage competition, which can increase liquidity and improve pricing.

By the close of 2011, the SEC had begun to lay the groundwork for regulating security-based swaps – the agency’s part of this complex new derivatives market – with a series of proposals regarding its fundamental legal, structural and definitional issues.

- The SEC, jointly with the CFTC, proposed rules further defining a number of key terms, including “swap,” “security-based swap,” “security-based swap agreement,” “swap dealer,” “security-based swap dealer,” “major swap participant,” and “major security-based swap participant.” These rules seek to clarify whether and how derivatives market participants will be subject to regulation, either as a result of the products in which they transact or the activities they undertake.
- The SEC proposed rules governing the registration and operation of security-based swap data repositories (SDRs), new entities that will collect transaction informa-

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tion on securities-related swap transactions and publicly disseminate it in real time. These rules also prescribe the manner in which transactions must be reported to SDRs, and how SDRs should disseminate transaction information.

- The SEC proposed rules regarding clearance of security-based swaps that are not covered by the end-user exemption. These rules would establish a process through which clearing agencies provide information to the SEC about the security-based swaps they plan to accept for clearing. The rules would also set minimum operational and governance standards for clearing agencies. Additionally, the SEC proposed rules setting forth the requirements to which end-users must adhere when they engage in security-based swap transactions that are exempt any from mandatory clearing requirement that may apply.
- The SEC proposed rules establishing a framework for the registration and regulation of swap execution facilities

(SEFs) – platforms on which security-based swaps required to be cleared may be traded. These regulations would encourage transparent and fair trading of security-based swaps.

- The SEC took steps to provide for the registration and regulation of security-based swap dealers and major security-based swap participants by, among other things, proposing rules establishing business conduct standards applicable to those entities.

Asset-Backed Securities

The collapse of the market for one type of asset-backed securities (ABS), those backed by residential subprime mortgages, was a precipitating event for the global financial crisis. Mortgage originators, able to transfer the risk of foreclosure to securitizers, allowed underwriting standards to collapse. Securitizers then transferred their risk to investors, who lost billions when mortgage-holders began defaulting on

an unprecedented scale. The SEC is pursuing regulations that would encourage high underwriting standards by aligning the interests of originators and securitizers with those of investors, and by ensuring that investors in these securities have access to the information needed to invest rationally.

- Risk retention requirements would ensure that securitizers have "skin in the game" and, thus, incentive to ensure quality underwriting. The SEC joined the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency and the Department of Housing and Urban Development in seeking public comment on a proposed rule that would require sponsors of ABS to retain at least five percent of the credit risk of the assets underlying the security.
- The SEC adopted rules requiring issuers of asset-backed securities to disclose the history of repurchase requests received and repurchases made, and requiring issuers of asset-backed securities to conduct a review of the assets underlying those securities.
- The SEC also adopted rules implementing the Dodd-Frank Act provision which requires ABS issuers in registered transactions to review the assets underlying the ABS and disclose the nature of the review.
- The SEC proposed a rule prohibiting material conflicts of interest between those who package and sell asset-backed securities and those who invest in them, helping ensure that entities which create and sell asset-backed securities cannot benefit at the expense of their clients, from the failure of those same securities.
- The SEC re-proposed for public comment rules requiring greater accountability and enhanced quality around ABS when issuers seek to use an expedited registration process known as "shelf registration." First proposed before that enactment of the Dodd-Frank Act, the revised proposal would require that an executive officer of the issuer certify the accuracy of the disclosure, that the securitization be designed to ensure cash flows sufficient to service expected payments, that a risk manager be appointed to review assets upon the occurrence of certain trigger events, and that dispute resolution procedures be in place in the event of a repurchase request.

Credit Rating Agencies

The collapse of billions of dollars of triple-A rated mortgage-backed securities was a key element of the financial crisis. Over-reliance on opinions issued by nationally recognized statistical rating organizations (NRSROs or, simply, rating agencies) left investors exposed to risks that were, in fact, far greater than the securities' initial ratings implied (many of these triple A securities were eventually downgraded to "junk" status).

Independent of financial reform legislation, the SEC had previously proposed rules that would lessen reliance on rating agencies by requiring that investors have access to data on the assets, including individual mortgage data, underlying ABS.

- In response to the Dodd-Frank Act, the SEC proposed rules and amendments intended to increase transparency and improve the integrity of credit ratings by requiring that NRSROs report on internal controls, protect against conflicts of interest, establish professional standards for credit analysts, publicly disclose the methodology used to determine individual ratings and enhance their public disclosures about the performance of their credit ratings.
- The SEC removed credit ratings as eligibility requirements for companies seeking to use "short-form" registration when registering securities for public sale. The SEC also proposed amendments to existing rules that would remove references to credit ratings in several rules under the Exchange Act, including rules concerning broker-dealer financial responsibility, distributions of securities, and confirmations of reserve requirements for broker-held excess margin securities. In addition, the SEC proposed removing credit rating references in certain rules and forms under the Investment Company Act of 1940, including Rule 2a-7, governing the operations of money market funds.

Executive Compensation

- The SEC adopted rules concerning shareholder approval of executive compensation and "golden parachute" compensation arrangements, requiring that say-on-pay

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votes occur at least once every three years and that a "frequency" vote be held at least once every six years. Companies also are required to provide additional disclosure regarding "golden parachute" compensation arrangements made with certain executive officers in connection with merger transactions.

- The SEC, jointly with the Federal Reserve and five other financial regulatory agencies, proposed a rule that would require certain financial institutions – including broker-dealers and investment advisers with \$1 billion or more in assets – to disclose the structure of their incentive-based compensation practices, and which would prohibit such institutions from maintaining compensation arrangements that encourage inappropriate risks.
- The SEC also proposed rules requiring the Commission to direct the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer that does not comply with new compensation committee and compensation adviser requirements.

Private Funds

- The SEC adopted rules requiring advisers to hedge funds and other private funds to register with the SEC and reallocating regulatory responsibility for smaller advisers to the states. In addition, the Commission approved rules that implement exemptions from registration for three types of private fund advisers: advisers solely to venture capital funds; advisers solely to private funds with less than \$150 million in assets under management in the U.S.; and certain private advisers without a place of business in the U.S.
- In a joint release with the CFTC, the Commission proposed a new rule that would require hedge fund advisers and other private fund advisers to report systemic risk information on a new form, Form PF (this proposal was adopted in October, 2011).
- The SEC adopted a rule defining "family offices" that will be excluded from the definition of an investment adviser under the Investment Advisers Act, and therefore not subject to regulation under the Act.

Other Significant Dodd-Frank Act Rulemakings

- The SEC proposed a rule creating a new process by which municipal advisers must register with the SEC, submitting detailed information and certifying that they have met or will meet the qualifications and regulatory obligations required of them. Required information would include contact information, a list of municipal advisory activities in which they engage, and disciplinary history. When adopted, this rule will supersede a more limited temporary rule adopted shortly after the passage of the Dodd-Frank Act.
- The SEC proposed rules that would require reporting issuers to disclose annually whether they use "conflict minerals" that originate from the Democratic Republic of the Congo or adjoining countries and are "necessary to the functionality or production" of a product that the issuer either manufactures or contracts to be manufactured.
- The SEC proposed rules that would require resource extraction issuers to disclose payments made by themselves, a subsidiary or any entity they control to the U.S. or foreign governments, including taxes, royalties, fees (including license fees), production entitlements and bonuses. Additionally, rules were proposed outlining the way in which mining companies must disclose to investors certain information about mine safety and health standards.
- The SEC created a Whistleblower Program that rewards insiders who provide the agency with high-quality tips that lead to successful enforcement actions. To be considered, a whistleblower must voluntarily provide the SEC with original information that leads to the successful enforcement by the SEC of a Federal court or administrative action and monetary sanctions totaling more than \$1 million. Under the program, whistleblowers will enjoy new protections. The new rules encourage company employees to report suspected wrongdoing internally, providing companies a strong incentive to have a credible, effective compliance program in place.

Dodd-Frank Act Studies

In addition to rulemakings, the Dodd-Frank Act requires the SEC to produce a number of reports. Among them:

- The SEC submitted to Congress a staff study on the standard of conduct applicable to broker-dealers and investment advisers who provide personalized investment advice to retail investors. The study concluded that, although retail investors generally expect that investment professionals (whether investment advisers or broker-dealers) are acting in their best interests, those investors are confused by the different standards of conduct that apply under the two regimes. The study concluded that retail customers should not have to parse legal distinctions to determine whether the advice they receive is provided in accordance with their expectations, and that a retail investor receiving personalized investment advice about securities should receive the same regulatory protections, regardless of whether the investor chooses to work with an investment adviser or a broker-dealer.
- To address this conclusion, the study made two primary recommendations; that the Commission exercise its discretionary rulemaking authority to implement a uniform fiduciary standard of conduct (which would be "no less stringent" than the standard that applies to investment advisers today) for broker-dealers and investment advisers when they provide personalized investment advice about securities to retail investors; and that the Commission consider harmonization of broker-dealer and investment adviser regulation when those financial professionals provide the same or substantially similar services to retail investors and when such harmonization adds meaningfully to investor protection.
- The SEC submitted, with the CFTC, a joint staff study required by the Dodd-Frank Act on "the feasibility of requiring the derivatives industry to adopt standardized computer-readable algorithmic descriptions which may be used to describe complex and standardized financial derivatives." The joint study concluded that current technology is capable of representing derivatives using a common set of computer-readable descriptions and that these descriptions are precise enough to use for the calculation of net exposures and to serve as part or all of a binding legal contract.

- The Commission submitted to Congress a staff study on the need for enhanced examination and enforcement resources for investment advisers that are registered with the Commission.

**Beyond the Dodd-Frank Act:
An Investor-Focused Rulemaking Agenda**

The SEC's rulemaking efforts extend beyond the boundaries of the Dodd-Frank Act, addressing priorities in areas not covered by that legislation.

- The SEC proposed amendments to the broker-dealer financial reporting rule that would strengthen the audits of broker-dealers and the SEC's oversight of broker-dealers' handling of their customers' securities and cash. Building on rules adopted in December, 2009 that strengthened custody controls for investment advisers, the proposed rules would reinforce the annual reporting and audits of broker-dealers by improving the focus on compliance with financial responsibility rules and related controls.
- The SEC made available to investors the detailed information that money market funds file with the agency, including information about a fund's investments and the market-based price of its portfolio known as its "shadow NAV" or mark-to-market valuation. The information is available on the SEC's website and is updated monthly.
- The SEC issued a concept release seeking public comment on the treatment of real estate investment trusts (REITs) and other mortgage-related pools under the Investment Company Act. At the same time, the Commission issued an advance notice of proposed rulemaking, seeking public input on possible amendments the agency might consider proposing to Rule 3a-7, which provides a conditional exclusion from the definition of "investment company" under the Investment Company Act for certain issuers of asset-backed securities.
- The SEC also issued a concept release seeking public comment on the use of derivatives by mutual funds and other investment companies registered under the Investment Company Act. The agency acted, among other causes, in light of recent significant growth in the

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holding of derivatives by mutual funds, exchange-traded funds and closed-end funds.

Increasing SEC Effectiveness through Structural Improvements

In 2011, the SEC continued to make strategic structural improvements, striving to build a more effective and well-managed agency, one in which organizations are appropriately aligned, administrative and logistical support is dynamic and efficient, operational controls are effective in mitigating operational risk, and all functions are supported with appropriate, upgraded information technology.

One area of significant focus this year was the work of the Boston Consulting Group (BCG), which was hired in response to a Dodd-Frank Act requirement that the SEC engage an independent consultant to conduct a broad assessment of the SEC's internal operations, structure, funding, and relationship with self-regulatory organizations (SROs).

BCG reported their findings in March, 2011, including numerous recommendations designed to increase the SEC's efficiency and effectiveness. In the months following the release of the BCG report, the SEC has developed the necessary program management and oversight infrastructure to respond to its key recommendations.

In 2011, the SEC continued to improve back office functions in its largest divisions and offices, creating "managing executive" positions to handle important support areas such as

information technology, workflow, data collection and analysis and human resources. The management professionals who have filled these positions have both improved deployment of limited resources and personnel and freed legal, examination and other professionals to focus their skills on mission-critical work.

On a broader level, several commission-wide infrastructure support functions previously housed under the Office of the Executive Director were consolidated with those residing in the Office of the Chief Operating Officer (OCCO), achieving economies of scale and improving management of the interdependencies between them. The physical security operation, previously fragmented in three separate offices, has been consolidated as well. Across infrastructure areas more generally, the SEC is moving its leasing operation to General Services Administration (GSA) and reducing the size of associated functions such as the construction branch.

The Office of Financial Management (OFM) made significant progress in improving internal controls, eliminating a material weakness from 2010. Also, OFM has been preparing for the migration of the SEC's financial system to a Federal Shared Service Provider (FSSP), with the transition on track for FY 2012 implementation.

In direct response to one of the BCG report's recommendations, the SEC has implemented a continuous cost reduction program that has identified a number of areas of potential savings, and has begun pulling back on these expenditures and repurposing the funds towards other mission-critical activities.



A number of significant technology infrastructure improvements were led by the Office of Information Technology (OIT), including implementation of a major component of the Enforcement Case Management system (HUB). This multi-year project is currently in the initial pilot of the software. Also in 2011, Electronic, Data Gathering, Analysis, and Retrieval (EDGAR) filers were migrated from a client-based filing application called EDGARLink onto a totally on-line filing interface called EDGARLink On-line, thus making filing with the Commission easier than ever. The SEC significantly reduced the technology implementation cost associated with new Dodd-Frank Act rules and realized an estimated savings of approximately

\$35 million by utilizing the EDGAR Filing Systems as the Dodd Frank Act filing data repository.

OIT also developed an enterprise architecture strategy and framework based on recommendations from a 2011 Mitre assessment and the BCG study's recommendations. This framework will be a strategic roadmap for better alignment of IT investments with the SEC's business units.

In addition, the organizational design of the OIT was changed to emphasize increased alignment with internal clients, improve coordination and increase efficiencies by centralizing activities such as application development and project management.

The Office of Human Resources (OHR) improved the recruiting and hiring process and achieved a 10 percent reduction in the average length of time required to fill external vacancies. Additionally, and in concert with the recommendations of the BCG study, the SEC has taken a strategic approach to restructuring the composition of the SEC's workforce, and is actively prioritizing external hiring needs, rather than simply back-filling open positions created by attrition. OHR also rolled out a new performance management system to the agency, and provided in depth training in the system to over 700 managers.

In addition to hiring and performance strategies designed to improve SEC institutional capacity, the SEC continues to expand its training and professional development efforts.

SEC staff participated in 89 separate learning events at SEC University's College of Securities and Investor Protection (CSIP), together receiving more than 6,000 certifications for completing programs in subjects such as forensic accounting, detection of financial fraud, and quantitative high frequency trading; in securities, financial, accounting, statistics, and business training; and in industry- and position-specific expertise that supports the agency's goals.

Staff who attended more than 170 College of Education Administration trainings are bringing new and upgraded skills to the SEC's financial management, IT and administrative functions, while the College of Leadership Development has delivered a diverse array of leadership programs to the men and women whose management abilities will help SEC performance continue to improve in the years ahead.

A new Chief Data Office has been created to integrate strategic goals for enterprise data across the lines of business and Office of Information Technology (OIT). The ultimate goal is to create a streamlined and sharable data architecture.

Additionally, the SEC has established an Operational Risk Management organization to assist in identification and mitigation of the operational risks the agency faces.

The agency has dramatically improved its ability to process Freedom of Information Act (FOIA) requests, in spite of unprecedented volume. 2011 saw a 10 percent increase in the number of requests received, on top of a 33 percent increase in 2010. The Commission has received more than 10,000 requests each of the past two years, yet has processed more requests than it received. The SEC closed 2011 with fewer requests pending than in any year since 2001.

While most observers rightly focus on front-line SEC functions, such as oversight and rulemaking, the SEC's leadership understands that back office activities are key components of effective front-line operations. Significant improvements in personnel, training and IT functions will help the SEC make the financial marketplace safer and more stable for all investors.

Conclusion

The SEC is matching its expanding responsibilities with an equally ambitious effort to enhance its performance at every level. The agency is improving internal logistics and staff abilities, focusing more effectively on emerging financial market developments, and infusing its rulemakings with ideas and strategies that reflect not just the growing expertise of SEC staff, but the intent of Congress and the experience of the market participants who will be most affected by agency actions.

The result is an agency increasingly responsive to the demands of the world's most important financial markets and those who participate in them – whether sophisticated professionals or the hundred million retail investors with assets in the market today.

Looking Forward

In FY 2012, the SEC expects to continue the trajectory it has followed through the last two years: pursuing a regulatory agenda consistent with recent statutory changes and the accelerating evolution in the financial markets; examining the structure of those markets with respect to current regulation; increasing the quality of the information investors receive and of their communications with companies and boards; and improving the agency's own internal functions and infrastructure.

As the agency moves towards completion of the rulemaking and reports required by the Dodd-Frank Act, the agency will increasingly focus on other priorities – many of them informed by securities market changes in the last decade.

Other areas of agency focus will include the quality of the information received by investors from registered entities, including U.S. disclosure mandates and the quality of the principles underlying financial accounting in a global financial marketplace. The agency will also continue to examine the proxy process, seeking ways in which communication between shareholders and boards might be made more effective and less cumbersome.

And, the SEC will continue to study the strengths and weaknesses of contemporary financial markets, soliciting the perspectives of a broad variety of market participants, and working to determine where action may increase market stability and investor confidence.

In order to more effectively pursue these initiatives as it continues to exercise oversight in areas of established responsibility, the SEC expects to continue improving its internal operations, including human resources, IT and financial controls. The SEC will also continue its Mission Advancement Program, the agency-wide effort to implement the recommendations contained in the Boston Consulting Group (BCG) management study required by the Dodd-Frank Act.

Rulemakings – Dodd-Frank and Beyond

- In 2012, the SEC plans to conclude the vast majority of the rulemaking required by the Dodd-Frank Act and subject to deadlines set by Congress.
- While the Dodd-Frank Act did not mandate a deadline for their adoption, the Commission will also consider additional executive compensation requirements. These will include rules mandating new listing standards relating to specified "clawback" policies, and new disclosure requirements for executive pay ratios, employee and director hedging, and the relationship between executive compensation and company performance.
- The Commission has already proposed a number of regulations required by Title VII of the Dodd-Frank Act related to the regulation of over-the-counter derivatives. While proposing and finalizing the remaining rules, the SEC will also continue working with other regulators and market participants to construct the new regulatory framework in a way that takes into account the steps market participants will need to take to comply with the new regulations, and the order in which those steps might best be taken. To that end, the SEC will seek public comment on a detailed implementation plan that will permit a roll-out of the new requirements in a logical, progressive, and efficient manner, while minimizing unnecessary disruption and costs.
- The SEC will continue to advance a number of studies required by the Dodd-Frank Act. Among these is a study of the credit rating process for structured finance products and the conflicts associated with the "issuer-pay" and the "subscriber-pay" models. A key part of this effort will be examining comments, proposals and data already received regarding the feasibility of establishing a system in which a public or private utility or a self-regulatory organization would assign agencies to individual rating projects, rather than continuing to rely on the current issuer-driven business model.

- The SEC will consider the recommendations of a staff study on the obligations of investment advisers and broker-dealers that there be a universal fiduciary standard of conduct which applies to both types of registrants when they are providing personalized investment advice to retail investors, and that regulations regarding the two professions be better harmonized.
- Other agency priorities arising from the Dodd-Frank Act will include rules intended to better protect investors in the asset-backed securities (ABS) market by improving the disclosure and offering process for ABS and prohibiting many material conflicts of interest by entities packaging and selling them; rules regarding the registration of municipal advisers; and rules requiring that reporting companies provide information about their use of certain "conflict minerals" in their products.
- One key rulemaking not related to the Dodd-Frank Act that the SEC expects to advance is the proposal to create a consolidated audit trail, which would allow regulators to track information related to trading orders received, routed and executed across multiple securities markets. The consolidated audit trail should allow the agency to rapidly reconstruct trading activity and quickly analyze both suspicious trading behavior and unusual market events.
- The SEC, working with a team from the Financial Stability Oversight Council, is considering further structural changes to money market funds, building on reforms adopted shortly after the financial crisis, during which the Reserve Primary Fund "broke the buck." These reforms would seek to address funds' susceptibility to runs and provide for a greater cushion in the case of an emergency.
- The SEC is also reviewing ways to reduce the regulatory burdens on smaller companies, particularly burdens associated with capital formation, in a manner consistent with the Commission's investor protection mandate. This review will consider, among other things, the rules related to the triggers for public reporting, communications in public and private offerings, and new capital raising strategies.



Responding to Current Market Structure

The SEC continues to examine a securities market structure where changes – particularly the emergence of high-speed, computer-driven trading – have outpaced the governing regulatory structure.

- Working with an eye towards preserving the efficiency, liquidity and competition benefits of current structure, the SEC will consider further possible reforms growing out of the unusual volatility markets displayed on May 6, 2010. These include the proposal by self-regulatory organizations to establish a new "limit up-limit down" mechanism and changes to the rules governing market-wide circuit breakers.
- An important issue related to high-frequency trading and the sophisticated electronic systems that drive today's markets is the risk of volume-induced market disruptions or unauthorized access to systems and networks. In 2012, the SEC expects to consider whether to make compliance with existing, voluntary Automation Review Policies mandatory. Doing so would require market participants – most of whom are already in compliance with these policies – to meet standards for the capacity, resiliency, and security of their automated systems.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Information and Communication

The quality of the communication between investors and the companies in which they invest is of paramount importance. Investors with access to accurate, timely information can make informed judgments about risk and allocate their capital efficiently. Investors are also more likely to take part in a market characterized by disclosure and communication, making additional capital available to growing enterprises.

- In 2012, the SEC will continue to encourage companies to enhance and clarify key information disclosed to investors, especially information that provides a better view into the risks companies face and the impact of operational decisions companies' management make.
- In addition, agency staff will develop recommendations related to the Commission's July 2010 "Proxy Plumbing" concept release, in which the Commission asked a number of questions about how communication between shareholders and company boards might be improved.
- The SEC will continue to consider incorporating International Financial Reporting Standards into the financial reporting system for U.S. domestic companies. The agency will take measured steps in accordance with the existing Work Plan towards the goal of global standards, while ensuring that the interests of U.S. investors in timely, accurate and comparable financial data remain the primary consideration.



Internal Reforms

SEC management recognizes that increased operational efficiency is critical to carrying out its mission at a time when the agency's responsibilities are growing faster than available resources. This requires continued focus on the technical, financial and managerial functions that allow the agency to carry out day-to-day operations more efficiently and to respond quickly, creatively and effectively to unanticipated events.

- A key priority for the SEC will be building on the significant progress made in strengthening its internal controls. The centerpiece of this effort will be completing the migration of the agency's financial system and some of its financial operations to the Federal Shared Service Provider (FSSP) at the Department of Transportation. Once completed, this initiative will yield significant benefits for the SEC in terms of enhanced system functionality and more streamlined operations. The SEC also will continue its multi-year efforts to remediate audit findings with respect to IT security financial reporting, registrant deposits, and accounting for budgetary resources.
- The Office of Information Technology will focus on EDGAR and SEC.gov modernization – improving system performance, adding features and enhancing the ability to manage Dodd-Frank Act data. Enhancements to the Tips, Complaints and Referrals system, and the Division of Enforcement's HUB system – its primary database – will extend their functionality and improve their ability to support improved business process workflow, search and auditing. The SEC will also focus on improving data management and the procurement of robust analytical tools with which to better analyze data.
- The agency will continue its Mission Advancement Program, working to implement recommendations resulting from the Dodd-Frank-mandated BCG study of the SEC's management. Following the release of the study in early 2011, the program office created 17 recommendation analysis workstreams. These workstreams will yield in suggested approaches for implementation and an estimate of the resources required.

SEC senior leadership is actively engaged in these efforts and serves on an Executive Steering Committee (ESC) established to oversee the implementation of the resulting initiatives.

- The agency expects to realize significant operational efficiencies and enhanced service provision through organizational redesigns of the Offices of Human Resources, Administrative Services and Financial Management, coupled with a focus on business process improvement initiatives in each of those activities.

In the year ahead, the SEC will enhance operations, infrastructure and management as part of its ongoing effort to become a more effective and dynamic agency. Making these changes, while implementing the Dodd-Frank Act, addressing market structure concerns and ensuring that information needed to make rational investment decisions is disclosed in a clear and timely fashion, will allow the SEC to continue improving investor safeguards and strengthening the U.S. capital markets.

Financial Highlights

This section provides an analysis of the financial position, results of operations, and the underlying causes for significant changes in balances presented in the SEC's FY 2011 financial statements.

Overview of Financial Position

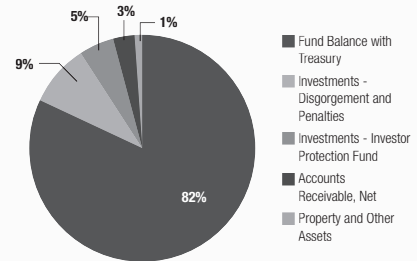
Assets. The SEC's total assets were \$8,517 million at September 30, 2011, an increase of \$355 million or 4 percent over FY 2010.

Investments, Net increased by \$278 million due to a \$453 million increase in Investor Protection Fund investments, and a \$175 million decrease in Disgorgement and Penalty related investments. Investor Protection Fund resources were invested in Treasury securities during the first quarter of FY 2011. The decrease in Disgorgement and Penalty investments is related to the SEC's continued efforts to accelerate distributions to harmed investors during FY 2011.

The increase in Accounts Receivable, Net of \$53 million is mainly comprised of a \$43 million increase in Section 31 fees receivable and a \$9 million increase in disgorgement and penalty accounts receivable (net) designated as payable to the U.S. Treasury General Fund upon collection.

Section 31 fees are payable to SEC twice a year: in March for the period September through December and in September for the period January through August. Thus, the year-end Section 31 accounts receivable balance is for securities transactions occurring during the month of September. The increase in Section 31 accounts receivable during FY 2011 is attributable to the increase in the fee rate from \$16.90 to \$19.20 and a 37 percent transaction volume increase when comparing September 2010 to September 2011.

**CHART 1.3
ASSETS BY TYPE**



**TABLE 1.2
ASSETS AS OF SEPTEMBER 30, 2011 AND 2010**

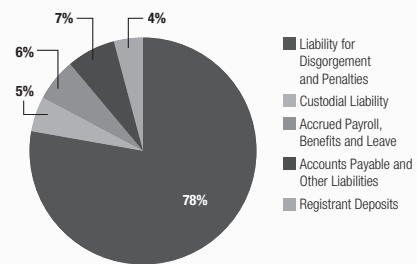
(DOLLARS IN MILLIONS)	FY 2011	FY 2010
Fund Balance with Treasury	\$ 6,996	\$ 6,989
Investments - Disgorgement and Penalties	750	925
Investments - Investor Protection Fund	453	-
Accounts Receivable, Net	214	161
Property and Equipment, Net	94	80
Other Assets	10	7
Total Assets	\$ 8,517	\$ 8,162

Liabilities. The SEC's total liabilities were \$1,106 million at September 30, 2011, a decrease of \$176 million or 14 percent from FY 2010. This decrease was mostly related to SEC's continued efforts to accelerate distributions to harmed investors. These distribution activities resulted in a \$158 million decrease in the Liability for Disgorgement and Penalties.

SEC's accrued liabilities for employee compensation and benefits decreased by \$16 million, mainly due to a shorter payroll accrual period at the end of FY 2011 when compared to FY 2010. On September 30, 2011, only five days remained in the pay period for which to accrue employee compensation and benefits, whereas on September 30, 2010, 14 days remained. In addition, Other Liabilities decreased by \$24 million due in part to the resolution of approximately \$10 million dollars in legal liabilities stemming from a complaint filed by the National Treasury Employees Union (NTEU) before the Federal Labor Relations Authority (FLRA) for retroactive wage adjustments.

Ending Net Position. The SEC's net position, comprised of both unexpended appropriations and the cumulative results of operations, increased by \$531 million or 8 percent between September 30, 2010 and September 30, 2011. The increase is primarily due to the increases in Section 31 and filing fee revenues discussed in the Results of Operations section below.

**CHART 1.4
LIABILITIES BY TYPE**



**TABLE 1.3
LIABILITIES AS OF SEPTEMBER 30, 2011 AND 2010**

(DOLLARS IN MILLIONS)	FY 2011	FY 2010
Liability for Disgorgement and Penalties	\$ 863	\$ 1,021
Custodial Liability	52	42
Accrued Payroll, Benefits and Leave	67	83
Accounts Payable	61	51
Registrant Deposits	47	45
Other Liabilities	16	40
Total Liabilities	\$ 1,106	\$ 1,282

Results of Operations

Earned Revenues. Total earned revenues for the year ended September 30, 2011 increased by \$261 million or 19 percent over the total for FY 2010. The growth in Section 31 revenues of \$115 million was driven by an increase in transactional volume and higher average fee rates in FY 2011 as compared to FY 2010. The \$143 million increase in filing fee revenue was primarily driven by higher average fee rates. The SEC adjusts the rates periodically in order to meet the annual offsetting collection targets specified in the Investor and Capital Markets Fee Relief Act of 2002. Other revenue is mainly related to post judgment interest on disgorgement and penalty receivables.

Section 31 fee rates are per million dollars of securities transacted on exchanges and over-the-counter markets. In the first quarter of FY 2010, the Section 31 fee rate was \$25.70. This rate was reduced to \$12.70 in the second quarter, and then increased to \$16.90 for the third and fourth quarters. The rate remained unchanged through the first quarter of FY 2011, but was increased to \$19.20 for the second, third and fourth quarters of FY 2011. The overall securities transaction volume subject to Section 31 fees increased 8 percent between FY 2010 and FY 2011.

Filing fee rates are per million dollars of registered securities. In the first quarter of FY 2010, the filing fee rate was \$55.80. The rate increased to \$71.30 in the second quarter of FY 2010. The rate remained unchanged until the second quarter of FY 2011 when it increased to \$116.10 for the remainder of the fiscal year.

Program Costs. Total Program Costs were \$1,148 million for the year ended September 30, 2011, an increase of \$90 million or 9 percent when compared to the prior year. The SEC's salary and benefit costs increased by \$43 million when comparing FY 2011 to FY 2010. Other costs increased \$47 million.

The SEC's number of full-time equivalents (FTEs) increased by 96 employees when comparing FY 2010 to FY 2011. This increase in FTEs is directly related to the agency's continued focus on hiring new staff with the requisite skills and experience to further the SEC's mission.

TABLE 1.4
EARNED REVENUES FOR THE YEARS ENDED
SEPTEMBER 30, 2011 AND 2010

(DOLLARS IN MILLIONS)	FY 2011	FY 2010
Section 31 Securities Transaction Fees	\$ 1,279	\$ 1,164
Section 6 (b) Securities Registration, Tender Offer, and Merger Fees	362	219
Other	3	—
Total	\$ 1,644	\$ 1,383

CHART 1.5
FILING FEE AND SECTION 31 EXCHANGE FEE RATES

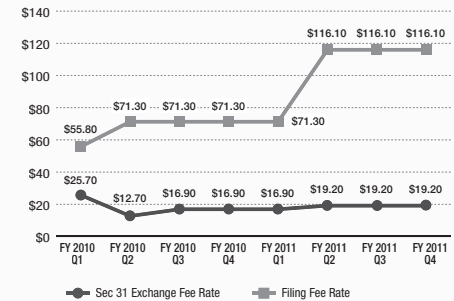
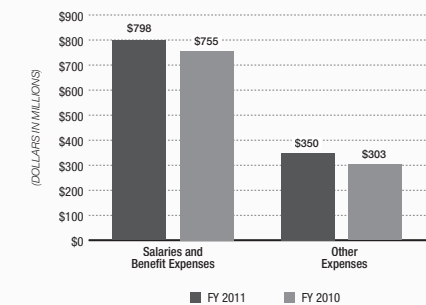


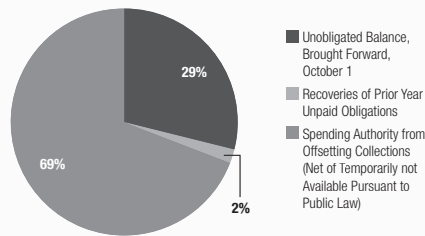
CHART 1.6
PROGRAM COSTS



Budgetary Resources

In FY 2011, the SEC's total budgetary resources equaled \$1,713 million, an 8 percent increase over the FY 2010 amount of \$1,593 million. SEC's budgetary resources are mostly derived from the following sources: (1) unobligated balances brought forward, (2) recoveries of prior year unpaid obligations, and (3) offsetting collections (net of amounts temporarily not available pursuant to public law).

**CHART 1.7
SOURCES OF FUNDS**



Unobligated Balance Brought Forward. The SEC's unobligated balance, brought forward was \$489 million for FY 2011, an increase of \$462 million over the FY 2010 total. The increase is primarily related to the carry forward of \$452 million in unobligated balances in the SEC's Investor Protection Fund.

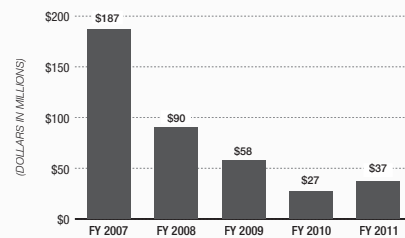
As detailed in *Chart 1.8, Unobligated Balance Brought Forward, General Funds – Salaries and Expenses*, the SEC has significantly reduced the amount of unobligated resources brought forward in its Salaries and Expenses Fund (X0100) since FY 2007.

Recoveries of Prior Year Unpaid Obligations. The SEC allocated significant resources to the review and de-obligation of unliquidated obligations from prior years during FY 2011. These efforts resulted in a \$20 million increase in recoveries when comparing FY 2010 to FY 2011.

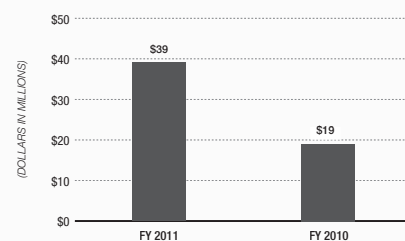
**TABLE 1.5
TOTAL BUDGETARY RESOURCES FOR THE YEARS ENDED
SEPTEMBER 30, 2011 AND 2010**

(DOLLARS IN MILLIONS)	FY 2011	FY 2010
Unobligated Balance, Brought Forward, October 1	\$ 489	\$ 27
Recoveries of Prior Year Unpaid Obligations	39	19
Appropriation – Investor Protection Fund	(1)	452
Spending Authority from Offsetting Collections, Earned, Collected	1,598	1,443
Amounts Temporarily not Available Pursuant to Public Law	(412)	(348)
Total Budgetary Resources	\$ 1,713	\$ 1,593

**CHART 1.8
UNOBLIGATED BALANCE, BROUGHT FORWARD, GENERAL FUNDS
— SALARIES AND EXPENSES**



**CHART 1.9
RECOVERIES OF PRIOR YEAR UNPAID OBLIGATIONS**



MANAGEMENT'S DISCUSSION AND ANALYSIS

Offsetting Collections. The SEC's budgetary authority from offsetting collections was \$1,598 for FY 2011. *Chart 1.10, Offsetting Collections vs. New Budgetary Authority¹* presents the SEC's budgetary authority and offsetting collections related to transaction fees and filing fees from FY 2003 through 2011. Offsetting collections in excess of budgetary authority provided by Congress is recorded as Temporarily not Available Pursuant to Public Law on the Statement of Budgetary Resources and is not available for obligation until approved by Congress. The SEC's budgetary authority from fee collections was \$1,185 million for FY 2011.

Status of Budgetary Resources. The SEC's Obligations Incurred increased by \$890 million or 81 percent during FY 2011. This increase was primarily related to the SEC's recognition of lease obligations totaling \$778 million to remedy issues noted in Comptroller General Decision B-322160, *Securities and Exchange Commission—Recording of Obligation for Multiple-Year Contract* and to accurately reflect the SEC's contractual obligations for leasing agreements in effect as of September 30, 2011. In addition, the SEC's Unobligated Balance decreased by \$769 million during FY 2011. This decrease was also attributable to the SEC's recognition of leasing obligations during FY 2011.

Investor Protection Fund

The SEC prepares stand alone financial statements for the Investor Protection Fund as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The financial statements are presented starting on page 155.

The Investor Protection Fund was established in the fourth quarter of FY 2010 to provide funding for a whistleblower award program and to finance the operations of the SEC Office of the Inspector General's Employee Suggestion Program. In FY 2010, \$452 million of non-exchange revenue was transferred to the Investor Protection Fund from SEC's disgorgement and penalties deposit fund. The \$452 million

CHART 1.10
OFFSETTING COLLECTIONS VS. NEW BUDGETARY AUTHORITY
SECTION 31 EXCHANGE AND FILING FEES

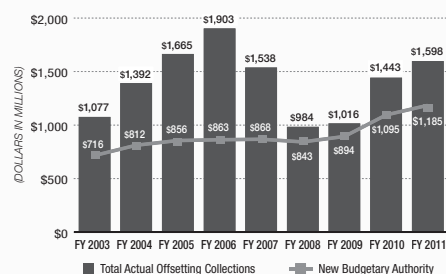


TABLE 1.6
INVESTOR PROTECTION FUND ACTIVITY
FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

(DOLLARS IN THOUSANDS)	FY 2011	FY 2010
Balance of Fund at beginning of preceding fiscal year	\$451,910	\$ -
Amount deposited into or credited to the Fund during the preceding fiscal year	-	451,910
Amount of earnings on investments during the preceding fiscal year	990	-
Amount paid from the Fund during the preceding fiscal year to whistleblowers	-	-
Amount paid from the Fund during the preceding fiscal year for expenses incurred by Employee Suggestion Program	(112)	-
Balance of the Fund at the end of the preceding fiscal year	\$ 452,788	\$ 451,910

¹ Chart 1.10 above only reflects offsetting collections related to fees collected on Section 31 securities transactions and Section 6(b), 13(e), 14(g), and 24f-2 filings and does not include reimbursable type collections and refunds as reported on the "Offsetting Collections" line of the Statement of Budgetary Resources.

in fund assets represented Fund Balance with Treasury as of September 30, 2010. The \$452 million was invested in U.S. Treasury Securities during the first quarter of FY 2011.

The Investor Protection Fund recognized non-exchange revenues totaling \$990 thousand during FY 2011. The non-exchange revenue represents interest earnings on amounts invested in U.S. Treasury Securities. In addition, the Investor Protection Fund incurred expenses of \$112 thousand for salary and benefit cost in the OIG's Employee Suggestion Program.

Additional information regarding the Investor Protection Fund and the Office of the Whistleblower is available in the 2011 Annual Report on the Dodd-Frank Whistleblower Program. This report may be found at <http://www.sec.gov/whistleblower>.

Limitations of the Financial Statements

The principal financial statements included in this report have been prepared by SEC Management to report the financial position and results of operations of the SEC, pursuant to the requirements of 31 U.S. Code Section 3515(b). While the statements have been prepared from the books and records of the SEC in accordance with GAAP for Federal entities and the formats prescribed by the Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the understanding that they are for a component of the U.S. Government, a sovereign entity.

Performance Highlights

This section provides key performance information for FY 2011. It outlines the SEC's strategic and performance planning framework, provides a brief discussion about how the SEC integrates its performance and budget data, and highlights the agency's progress toward reaching planned performance targets. Additionally, this section includes a list of performance indicators that provide useful information for understanding the agency's activities.

Strategic and Performance Planning Framework

The SEC's FY 2011 strategic and performance planning framework, is based on the FY 2010 – FY 2015 Strategic Plan, available at <http://www.sec.gov/about/secstratplan1015f.pdf>. The Strategic Plan addresses the agency's mission, vision, values, and strategic goals and outcomes. The SEC's work is structured around four strategic goals, and 12 strategic outcomes that gauge the SEC's performance within each goal.

The SEC's goals and priorities in the Strategic Plan are influenced by several external environmental factors, including the demands of fulfilling the agency mission in complex and

global financial markets and changes in legislation affecting the agency. During the past few years, this environment has changed dramatically. While the Strategic Plan attempts to foresee various ways in which financial markets, regulated industries, and the legislative environment may change over time, no plan can anticipate all possible scenarios. Because the accompanying performance measures were significantly revised during the development of the FY 2010 – FY 2015 Strategic Plan, there is limited prior year performance information provided in this report.

TABLE 1.7

Strategic Goals with Resources Invested	Outcomes
Foster and enforce compliance with the Federal securities laws Cost: \$622.9 million	The SEC fosters compliance with the Federal securities laws.
	The SEC promptly detects violations of the Federal securities laws.
	The SEC prosecutes violations of Federal securities laws and holds violators accountable.
Establish an effective regulatory environment Cost: \$126.4 million	The SEC establishes and maintains a regulatory environment that promotes high-quality disclosure, financial reporting, and governance, and prevents abusive practices by registrants, financial intermediaries, and other market participants.
	The U.S. capital markets operate in a fair, efficient, transparent, and competitive manner, fostering capital formation and useful innovation.
	The SEC adopts and administers rules and regulations that enable market participants to understand clearly their obligations under the securities laws.
Facilitate access to the information investors need to make informed investment decisions Cost: \$185.9 million	Investors have access to high-quality disclosure materials that are useful to investment decision making.
	Agency rulemaking and investor education programs are informed by an understanding of the wide range of investor needs.
Enhance the Commission's performance through effective alignment and management of human, information, and financial capital Cost: \$212.9 million	The SEC maintains a work environment that attracts, engages, and retains a technically proficient and diverse workforce that can excel and meet the dynamic challenges of market oversight.
	The SEC retains a diverse team of world-class leaders who provide motivation and strategic direction to the SEC workforce.
	Information within and available to the SEC becomes a Commission-wide shared resource, appropriately protected, that enables a collaborative and knowledge-based working environment.
	Resource decisions and operations reflect sound financial and risk management principles.

Performance Measures Overview

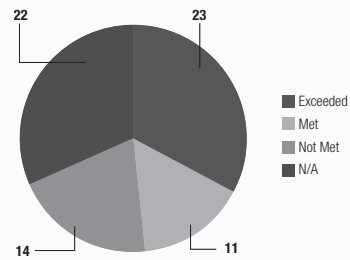
To assess the SEC's performance results against pre-established performance targets, a results rating methodology is used to assign one of the following three performance ratings for a given result:

Below Target	On Target	Above Target
Not Met	Met	Exceeded

The SEC's FY 2010 – FY 2015 Strategic Plan outlines 70 total performance targets. Several of these performance measures track multiple performance targets, and *Chart 1.11, Summary of FY 2011 Performance Results* shows the performance results for each of the 70 performance targets. Twenty-two of these targets are categorized as N/A if the performance target was not established or if FY 2011 data is not available. Several of these performance measures are under review as part of the FY 2011 Strategic Plan Addendum process in order to allow for more complete and accurate reporting.

The performance indicators, outlined in *Table 1.9, Performance Indicators Results Summary*, do not include planned targets because it would be inappropriate for the agency to conduct certain activities with an eye towards meeting predetermined targets. Therefore, results for performance indicators are not included in *Chart 1.11, Summary of FY 2011 Performance Results*.

**CHART 1.11
SUMMARY OF FY 2011 PERFORMANCE RESULTS**



MANAGEMENT'S DISCUSSION AND ANALYSIS

Performance Results Summary

The SEC has established a series of performance measures for assessing program performance against strategic goals and planned outcomes. For each performance measure, one or more performance targets have been established. *Table 1.8, Performance Measures Results Summary* provides a summary of actual performance results during FY 2010 and FY 2011 for each performance measure, and *Table 1.9, Performance Indicators Results Summary* provides a summary of indicators by outcome within each strategic goal. A detailed discussion of the agency's program achievements and performance results is located in the *Performance Section* beginning on page 51.

TABLE 1.8

PERFORMANCE MEASURES RESULTS SUMMARY				
GOAL 1: Foster and Enforce Compliance with the Federal Securities Laws				
OUTCOME 1.1: The SEC fosters compliance with the Federal securities laws.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 1: Number of new investor education materials designed specifically to help investors protect themselves from fraud	16	24	24	Met
MEASURE 2: Number of industry outreach and education programs targeted to areas identified as raising particular compliance risks	6	10	5	Not Met
MEASURE 3: Percentage of firms receiving deficiency letters that take corrective action in response to all exam findings	90%	90%	93%	Exceeded
MEASURE 4: Percentage of attendees at CCO outreach that rated the program as "Useful" or "Extremely Useful" in their compliance efforts	77%	80%	86%	Exceeded
OUTCOME 1.2: The SEC promptly detects violations of the Federal securities laws.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 5: Percentage of cause and special exams (sweeps) conducted as a result of risk assessment process that includes multi-divisional input	N/A	N/A	N/A	N/A
MEASURE 6: Percentage of advisers deemed "high risk" examined during the year	N/A	N/A	N/A	N/A
MEASURE 7: Percentage of registrant population examined during the year:				
Investment advisers	9%	11%	8%	Not Met
Investment companies	10%	11%	13%	Exceeded
Broker-dealers (exams by SEC and SROs)	44%	45%	42%	Not Met
MEASURE 8: Percentage of non-sweep and non-cause exams that are concluded within 120 days	48%	50%	53%	Exceeded
OUTCOME 1.3: The SEC prosecutes violation of Federal securities laws and holds violators accountable.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 9: Percentage of enforcement actions successfully resolved	92%	92%	93%	Exceeded
MEASURE 10: Percentage of first enforcement actions filed within two years	67%	70%	61%	Not Met
MEASURE 11: Percentage of debts where either a payment has been made or a collection activity has been initiated within six months of the due date of the debt	86%	90%	91%	Exceeded
MEASURE 12: Percentage of Fair Fund and disgorgement fund plans that distributed the final tranche of funds to injured investors within 24 months of the order appointing the fund administrator	N/A	N/A	N/A	N/A
MEASURE 13: Percentage of Fair Fund and disgorgement fund plans approved by final order within the prior fiscal year which had a first tranche of funds distributed under those plans within 12 months of such approval date	N/A	N/A	N/A	N/A

N/A – Signifies data does not currently exist or targets were not established

(Continued on next page)

TABLE 1.8 Continued from previous page

PERFORMANCE MEASURES RESULTS SUMMARY (continued)				
GOAL 2: Establish an Effective Regulatory Environment				
OUTCOME 2.1: The SEC establishes and maintains a regulatory environment that promotes high-quality disclosure, financial reporting, and governance, and that prevents abusive practices by registrants, financial intermediaries, and other market participants.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 1: Survey on quality of disclosure	N/A	N/A	N/A	N/A
MEASURE 2: Number of consultations; joint events, reports, or initiatives; and joint examinations and other mutual supervisory efforts with SROs and other Federal, state, and non-U.S. regulators	N/A	N/A	N/A	N/A
MEASURE 3: Number of non-U.S. regulators trained	1,997	2,020	1,765	Not Met
OUTCOME 2.2: The U.S. capital markets operate in a fair, efficient, transparent, and competitive manner, fostering capital formation and useful innovation.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 4: Percentage of transaction dollars settled on time each year	99%	99%	99%	Met
MEASURE 5: Average institutional transaction costs for exchange listed stocks on a monthly basis	N/A	N/A	N/A	N/A
MEASURE 6: Percentage of market outages at SROs and electronic communications networks (ECNs) that are corrected within targeted timeframes:				
Within 2 hours	74%	60%	88%	Exceeded
Within 4 hours	85%	75%	94%	Exceeded
Within 24 hours	100%	96%	100%	Exceeded
OUTCOME 2.3: The SEC adopts and administers rules and regulations that enable market participants to understand clearly their obligations under the securities laws.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 7: Length of time to respond to written requests for no-action letters, exemptive applications, and written interpretive requests				
Trading and Markets – No-action letters, exemptive applications, and written interpretive requests (combined figure)	91%	85%	98.5%	Exceeded
Investment Management – No-action letters and interpretive requests	100%	75%	100%	Exceeded
Investment Management – Exemptive applications	100%	80%	100%	Exceeded
Corporation Finance – No-action letters and interpretive requests	97%	90%	97%	Exceeded
Corporation Finance – Shareholder proposals	100%	100%	100%	Met
MEASURE 8: Survey on whether SEC rules and regulations are clearly understandable	N/A	N/A	N/A	N/A
MEASURE 9: Time to complete SEC review of SRO rules that are subject to SEC approval				
Within 35 days	73%	40%	0%	Not Met
Within 45 days	99%	80%	82%	Exceeded

N/A – Signifies data does not currently exist or targets were not established

(Continued on next page)

Management's Discussion and Analysis

MANAGEMENT'S DISCUSSION AND ANALYSIS

TABLE 1.8 Continued from previous page

PERFORMANCE MEASURES RESULTS SUMMARY (continued)				
GOAL 3: Facilitate Access to the Information Investors Need to Make Informed Investment Decisions				
OUTCOME 3.1: Investors have access to high-quality disclosure materials that are useful to investment decision making.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 1: Percentage of public companies and investment companies with disclosures reviewed each year				
Corporations	44%	33%	48%	Exceeded
Investment company portfolios	35%	33%	33%	Met
MEASURE 2: Time to issue initial comments on Securities Act filings	24.1 days	< 30 days	24.4 days	Met
MEASURE 3: Percentage of investment company disclosure reviews for which initial comments are completed within timeliness goals				
Initial registration statements	93%	85%	92%	Exceeded
Post-effective amendments	94%	90%	94%	Exceeded
Preliminary proxy statements	99%	99%	98%	Not Met
MEASURE 4: Point of sale "click-through rate"	N/A	N/A	N/A	N/A
MEASURE 5: Access to broker-dealer and investment adviser background checks				
BrokerCheck System	N/A	N/A	N/A	N/A
IAPD System	N/A	N/A	N/A	N/A
MEASURE 6: Investor demand for disclosures on municipal securities	N/A	N/A	N/A	N/A
MEASURE 7: Satisfaction index for disclosure process	N/A	N/A	N/A	N/A
OUTCOME 3.2: Agency rulemaking and investor education programs are informed by an understanding of the wide range of investor needs.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 8: Number of investors reached, and number of in-person events with specifically targeted communities and organizations				
Number of investors reached (in millions)	17.8	16	14.8	Not Met
Number of in-person events	42	30	48	Exceeded
MEASURE 9: Number of investor educational initiatives organized and produced	9	10	11	Exceeded
MEASURE 10: Timeliness of responses to investor contacts				
Closed within 7 days	72%	80%	67%	Not Met
Closed within 30 days	93%	90%	92%	Exceeded
MEASURE 11: Percentage of rules impacting investors that are presented in alternate user-friendly formats	100%	100%	100%	Met
MEASURE 12: Customer satisfaction with usefulness of investor educational programs and materials	N/A	N/A	N/A	N/A

N/A – Signifies data does not currently exist or targets were not established

(Continued on next page)

TABLE 1.8 Continued from previous page

PERFORMANCE MEASURES RESULTS SUMMARY (continued)				
GOAL 4: Enhance the Commission's Performance Through Effective Alignment and Management of Human, Information, and Financial Capital				
OUTCOME 4.1: The SEC maintains a work environment that attracts, engages, and retains a technically proficient and diverse workforce that can excel and meet the dynamic challenges of market oversight.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 1: Survey of employee engagement	58%	65%	61%	Not Met
MEASURE 2: Best Places to Work ranking	Ranked #24	Ranked #5	N/A	N/A
MEASURE 3: Turnover	5%	< 8%	6.4%	Met
MEASURE 4: Expanding staff expertise	N/A	N/A	9%	N/A
MEASURE 5: Size of competency gaps	N/A	10%	N/A	N/A
MEASURE 6: Number of diversity-related partnerships/alliances	2	5	10	Exceeded
MEASURE 7: Survey feedback on the quality of the SEC's performance management program	N/A	65%	53%	Not Met
OUTCOME 4.2: The SEC retains a diverse team of world-class leaders who provide motivation and strategic direction to the SEC workforce.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 8: Quality of hire	N/A	75%	N/A	N/A
MEASURE 9: Leadership competency gaps	N/A	10%	N/A	N/A
MEASURE 10: Satisfaction with Leadership Development Program (5-point scale)	4.46	4.5	4.49	Not Met
OUTCOME 4.3: Information within and available to the SEC becomes a Commission-wide shared resource, appropriately protected, that enables a collaborative and knowledge-based working environment.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 11: Percentage of SEC data sources accessible through a virtual data warehouse, and milestones achieved towards the creation of a robust information management program	N/A	N/A	N/A	N/A
MEASURE 12: Deployment of document management and workflow tools	Enforcement and Examination	Tips, Complaints and Referrals Commission-wide	Tips, Complaints and Referrals Commission-wide	Met
MEASURE 13: Time to process evidentiary material for enforcement investigations	N/A	N/A	N/A	N/A
MEASURE 14: System availability				
Systems availability	99.97%	99.3%	99.94%	Exceeded
Percentage fail over within 4 hours	N/A	100%	0%	Not Met
Systems virtualized	22%	25%	38%	Exceeded
OUTCOME 4.4: Resource decisions and operations reflect sound financial and risk management principles.	FY 2010 Actual	FY 2011 Target	FY 2011 Actual	FY 2011 Results
MEASURE 15: Milestones achieved towards establishment of a robust data management program	N/A	Administrative Data and Reporting Requirements Identified	Administrative Data and Reporting Requirements Identified	Met
MEASURE 16: Financial Systems Integration	N/A	17%	N/A	N/A
MEASURE 17: Financial Audit Results				
Unqualified opinion	Yes	Yes	Yes	Met
Material weaknesses	2	0	0	Met
Significant deficiency	0	0	4	Not Met

N/A – Signifies data does not currently exist or targets were not established

MANAGEMENT'S DISCUSSION AND ANALYSIS

TABLE 1.9

PERFORMANCE INDICATORS RESULTS SUMMARY		
GOAL 1: Foster and Enforce Compliance with the Federal Securities Laws		
OUTCOME 1.1: The SEC fosters compliance with the Federal securities laws.	FY 2010 Actual	FY 2011 Actual
INDICATOR 1: Percentage of actions identified as "high impact" which have resulted in significant corrective industry reaction	N/A	N/A
INDICATOR 2: Annual increases or decreases in the number of CCOs attending CCO outreach programs	N/A	N/A
OUTCOME 1.2: The SEC promptly detects violations of the Federal securities laws.	FY 2010 Actual	FY 2011 Actual
INDICATOR 3: Percentage of exams that identify deficiencies, and the percentage that result in a "significant finding"		
Percentage identify deficiencies	72%	82%
Percentage that result in a "significant finding"	42%	42%
INDICATOR 4: Number of investigations or cause exams from tips:		
Number of investigations	303	349
Number of cause exams	N/A	N/A
OUTCOME 1.3: The SEC prosecutes violations of Federal securities laws and holds violators accountable.	FY 2010 Actual	FY 2011 Actual
INDICATOR 5: SEC investigations referred to SROs or other state, Federal, and foreign authorities for enforcement	492	586
INDICATOR 6: Percent of all enforcement investigations deemed "high impact"	3.26%	5.11%
INDICATOR 7: Percent of investigations that come from internally-generated referrals or prospects	21.9%	18.5%
INDICATOR 8: Criminal investigations relating to SEC investigations	139	134
INDICATOR 9: Disgorgement and penalties ordered and the amounts collected by the SEC:		
Ordered amounts (in millions)	\$2,846	\$2,806
Collected amounts (in millions)	\$1,775	\$1,281
INDICATOR 10: Requests from foreign authorities for SEC assistance and SEC requests for assistance from foreign authorities		
Number of requests from foreign authorities	457	492
Number of SEC requests	605	772
GOAL 2: Establish an Effective Regulatory Environment		
OUTCOME 2.1: The SEC establishes and maintains a regulatory environment that promotes high-quality disclosure, financial reporting and governance, and that prevents abusive practices by registrants, financial intermediaries, and other market participants.	FY 2010 Actual	FY 2011 Actual
INDICATOR 1: Average cost of capital in U.S. relative to the rest of the world	10.99%	10.67%
OUTCOME 2.2: The U.S. capital markets operate in a fair, efficient, transparent and competitive manner, fostering capital formation and useful innovation.	FY 2010 Actual	FY 2011 Actual
INDICATOR 2: Average quoted spread for exchange listed stocks on a monthly basis (in cents)	2.52	1.76
INDICATOR 3: Average effective spread for exchange listed stocks on a monthly basis (in cents)	2.65	1.72
INDICATOR 4: Speed of execution (in seconds)	1.77	1.02
INDICATOR 5: Average quoted size of exchange listed stocks on a monthly basis	687	606
INDICATOR 6: Average daily volatility of exchange listed stocks on a monthly basis	1.18%	1.26%
OUTCOME 2.3: The SEC adopts and administers rules and regulations that enable market participants to understand clearly their obligations under the securities laws.	FY 2010 Actual	FY 2011 Actual
INDICATOR 7: Percentage of SRO rule filings that are submitted for immediate effectiveness	69%	77%

N/A – Signifies data does not currently exist for existing or newly added measures

Management Assurances

The SEC is firmly committed to building and maintaining strong internal controls. Internal control is an integral component of effective agency management, providing reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with laws and regulations. The Federal Managers' Financial Integrity Act of 1982 (FMFIA) provides the statutory basis for management's responsibility for and assessment of internal accounting and administrative controls. Such controls include program, operational, and administrative areas, as well as accounting and financial management. The FMFIA requires Federal agencies to establish controls that reasonably ensure obligations and costs are in compliance with applicable law; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures are properly recorded and accounted for to maintain accountability over the assets. The FMFIA also requires agencies to annually assess and report on the internal controls that protect the integrity of Federal programs (FMFIA § 2) and whether financial management systems conform to related requirements (FMFIA § 4).

Guidance for implementing the FMFIA is provided through Office of Management and Budget (OMB) Circular A-123. In addition to requiring agencies to provide an assurance statement on the effectiveness of programmatic internal controls and financial system conformance, the Circular requires agencies to provide an assurance statement on the effectiveness of internal control over financial reporting.

In addition, Section 963 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) describes the responsibility of SEC management to establish and maintain adequate internal controls and procedures for financial reporting. The Dodd-Frank Act requires an annual financial controls audit, an assessment of the effectiveness of internal control, and an attestation by the Chairman and Chief Financial Officer. Section 922 of the Dodd-Frank Act requires the SEC to submit audited financial statements of the Investor Protection Fund, to the Committee on Banking, Housing and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

The following Assurance Statement is issued in accordance with the FMFIA, OMB Circular A-123 and Sections 922 and 963 of the Dodd-Frank Act.

Annual Assurance Statement

Assurance Statement Under FMFIA: The management of the SEC is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act of 1982. In accordance with OMB Circular A-123, the SEC conducted its annual assessment of the effectiveness of internal controls. Based on the results of the assessment for the period ending September 30, 2011, the SEC is able to provide an unqualified statement of assurance that internal controls and the financial systems, both for the agency as a whole and for the Investor Protection Fund, meet the objectives of the FMFIA. No material weaknesses were found in the design or operation of the internal controls for the fiscal year ended September 30, 2011.

Assurance Statement On Internal Controls Over Financial Reporting: In accordance with Appendix A of OMB Circular A-123, the SEC conducted its assessment of the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. Based on the results of the assessment, the SEC is able to provide reasonable assurance that internal controls over financial reporting, both for the agency as a whole and for the Investor Protection Fund, met the objectives of FMFIA and were operating effectively as of September 30, 2011, and that no material weaknesses were found in the design or operation of the controls.



Mary Schapiro
Chairman
November 14, 2011



Kenneth A. Johnson
Chief Financial Officer
November 14, 2011

Management's Responsibility for Internal Control

FMFIA requires the head of the agency, based on the agency's internal evaluation, to provide an annual Statement of Assurance on the effectiveness of their management, administrative, and financial reporting controls. OMB Circular A-123, *Management's Responsibility for Internal Control*, implements the FMFIA and defines management's responsibility for internal control in Federal agencies.

FMFIA § 2 requires agencies to establish internal controls and financial systems that provide reasonable assurance that the following objectives are achieved:

- Effective and efficient operations,
- Compliance with applicable laws and regulations, and
- Reliability of financial reporting.

FMFIA § 4 requires that agencies annually evaluate and report on whether financial management systems conform to Government-wide requirements. The SEC evaluated its financial management systems for the fiscal year ending September 30, 2011, in accordance with the Federal Financial Management Improvement Act of 1996 (FFMIA) and OMB Circular A-127, *Financial Management Systems*, as applicable.

Appendix A of OMB Circular A-123 requires the agency head to provide a separate statement of assurance on the effectiveness of internal control over financial reporting (ICFR), in addition to the overall FMFIA assurance statement. The 2011 annual assurance statements for FMFIA and ICFR are provided on the preceding page. This report also provides a Summary of Financial Statement Audits and Management Assurances under the section entitled Other Accompanying Information, as required by OMB Circular A-136, *Financial Reporting Requirements*.

As part of the overall FMFIA assurance process, SEC management assessed internal control at the entity-level, as well as at the process, transaction, and application level. To assess the effectiveness of entity-level controls, SEC management used the Government Accountability Office's

(GAO) document, titled *Internal Control Management and Evaluation Tool* (GAO-01-1008G) to define entity-level control objectives. SEC management then identified changes to control activities from the prior year that addressed each control objective. Information on these entity-level control activities was gathered through meetings with relevant points of contact and feedback in the form of survey responses from SEC supervisors. Entity-level control activities were also evaluated based on risk and control documentation, as well as the assessments conducted by the divisions and offices for providing management assurances over the effectiveness of programmatic and operational controls and compliance with laws and regulations.

The effectiveness of process-level controls was assessed through detailed test procedures related to the agency's financial reporting objectives. As part of this effort, the agency performed a comprehensive risk assessment in which SEC management identified:

- Significant financial reports and materiality;
- Significant line items, accounts, disclosures, and laws and regulations;
- Major classes of transactions;
- Relevant assertions, risks of material misstatement and control objectives;
- Reporting and regulatory requirements; and
- Existing deficiencies and corrective action plans.

From the results of the risk assessment, SEC management updated documentation of the business processes and control activities designed to mitigate significant financial reporting and compliance risks. These control activities were tested for design and operating effectiveness. The agency also tested for operating effectiveness those control activities that were found deficient in prior years and remediated in FY 2011. The test results served as a basis for management's assessment of the effectiveness of internal control over financial reporting.

¹ A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

² A material weakness is a deficiency, or combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the financial statements or other significant financial reports, will not be prevented, detected, or corrected on a timely basis.

SEC management analyzed the internal control deficiencies, both individually and in the aggregate, to determine if a significant deficiency¹ or a material weakness² exists in the financial reporting processes. Significant factors considered for assessing each deficiency included the following:

- Nature of the control deficiency (e.g., design, operation);
- Internal control objectives and activities impacted;
- Potential impact on financial statement line items, accounts, and disclosures;
- The interaction of control deficiencies with other deficiencies; and
- The materiality of account balances impacted by the deficiency.

In addition, each division director and office head provided a statement of assurance identifying any internal control weaknesses or management challenges related to the effectiveness of the controls over programs and operations, and compliance with laws and regulations. These statements were based on information gathered from various sources including, among other things:

- Internal management reviews, self-assessments, and tests of internal controls;
- Management's personal knowledge gained from daily operations;
- Reports from the GAO and the SEC's Office of Inspector General (OIG);
- Reviews of financial management systems under OMB Circular A-127, Financial Management Systems;
- Annual performance plans and reports pursuant to the Federal Information Security Management Act (FISMA) and OMB Circular A-130, Management of Federal Information Resources;
- Annual reviews and reports pursuant to the Improper Payments Elimination and Recovery Act;
- Reports and other information from Congress or agencies such as OMB, the Office of Personnel Management (OPM), or the General Services Administration (GSA) reflecting the adequacy of internal controls; and

- Additional reviews relating to a division or office's operations, including those discussed in the Other Reviews section below.

Each year, the agency's Financial Management Oversight Committee advises the Chairman as to whether the SEC had any deficiencies in internal control or financial system design significant enough to be reported as a material weakness or non-conformance. This advice is based on the assurance statements from directors and office heads and other supplemental sources of information. Among other factors, the SEC considered the implications of Antideficiency Act violations in FY 2010 and previous years related to a GAO opinion on the SEC's leasing program, which is discussed in *Note 14.C. Other Budgetary Disclosures*.

Other Reviews

GAO audited the SEC's financial statements. The objective of GAO's audit was to express an opinion on the financial statements and on internal control over financial reporting and to report on tests of compliance with selected laws and regulations.

The OIG conducted 14 audits and reviews during the fiscal year. The reviews covered 17 of the 35 assessable units (49 percent). Some components had multiple reviews.

Status of Prior Year Internal Control over Financial Reporting Issues

The SEC's FY 2010 financial audit and ICFR assessment identified two material weaknesses in internal control over financial reporting, one in information systems and a second in financial reporting and accounting processes. The second material weakness resulted from the combination of five significant deficiencies.

Based on the agency's continued efforts to address prior year audit findings and ICFR weaknesses, the agency successfully remediated both material weaknesses. The issues disclosed in the FY 2010 PAR related to disgorgement and penalty transactions and required supplementary information were either fully remediated or reduced to control deficiencies as a result of the remedial actions that were focused on strengthening controls and improving management's monitoring and oversight. Although the agency has four significant deficiencies, in the areas of financial reporting, budgetary resources, filing

MANAGEMENT'S DISCUSSION AND ANALYSIS

fees, and IT security, the agency made significant improvement in addressing these four deficiency areas. In addition, the agency continued in FY 2011 to perform a robust internal control assessment and improved its process to effectively manage, track, monitor and test key risks and controls.

Below is a summary of the agency's efforts to remediate the six areas that constituted the two material weaknesses in FY 2010.

Information Systems. In FY 2011, the SEC successfully remediated its material weakness in the area of information systems and reduced it to the level of a significant deficiency. The SEC undertook corrective actions in FY 2011 to address information technology and security control weaknesses which spanned across its general support system and key applications.

During FY 2011, the Office of Information Technology (OIT) updated patches across the agency's financial systems and improved backup processes to ensure the recovery of critical financial data. OIT also continued to aggressively work to resolve outstanding information security control deficiencies identified by management through its certifications and accreditations and by prior-year audits. The SEC improved its monitoring capability over system configuration changes, so that all changes to system requirements, design, and scripts are evaluated by a Configuration Control Board on the basis of cost, benefits, and risk to the agency. Future system upgrades are documented to show both the impact on security and evidence of approval by the Board. The agency also made notable progress with respect to user access controls and segregation of duties.

New and residual deficiencies were identified during the SEC's FY 2011 assessment including dated security risk management procedures, inconsistent continuous monitoring processes to support FISMA requirements, user account control gaps, and further improvements needed in the patch management process. These areas will be a priority for remediation in FY 2012.

Disgorgement and Penalties. The SEC successfully remediated this significant deficiency, through efforts to improve the controls and procedures that ensure that accounts receivables and payments related to disgorgements and penalties were recorded accurately and in the proper accounting period.

Some of the improved control activities implemented by the SEC were as follows:

- Instituting a more comprehensive monthly review of Court Link/Lexis Nexus for valid judgments/court orders against new and existing SEC civil cases for new receivables or subsequent transfer orders;
- Implementing procedures to age receivables and to record post-judgment interest;
- Establishing a new process for recording deposits in transit to ensure all checks received are recognized in the proper accounting period; and
- Implementing an automated interface between the SEC's current core financial system and the Bureau of Public Debt's FedInvest system to record purchases and redemptions for tracking investments at the detailed level held in the Disgorgement Deposit Fund account.

New and residual deficiencies were identified during the SEC's FY 2011 assessment, but these deficiencies, even when considered in aggregate, do not rise to the level of a significant deficiency.

Required Supplementary Information. In FY 2011, the SEC successfully resolved its previous significant deficiency regarding the required supplemental information, particularly with respect to the new Investor Protection Fund. The SEC prepared the required supplementary information during FY 2011, and formalized the process of performing a detailed review of OMB Circular A-136 *Financial Reporting Requirements* and other relevant guidance to ensure that such requirements are properly reflected in the agency's financial statements.

Financial Reporting. This process area continues to have a significant deficiency in FY 2011. Many of the agency's financial reporting processes are still manual in nature and reliant on spreadsheets and databases to both initiate transactions and perform key control functions.

During FY 2011, the SEC was able to reduce the number of manual processes by tracking investments at the detail level within the financial system and building an automated interface with the Bureau of Public Debt for handling investments. In addition, SEC reduced the number of manual journal vouchers by implementing the use of standard

vouchers for recurring types of journal vouchers. The agency implemented a remediation plan to control its user developed applications (UDAs), such as Microsoft Access databases and spreadsheets, based on risk.

While the SEC made significant improvement in this area, the agency still continues to have deficiencies related to financial reporting. Most notably, the agency's remediation related to UDAs went into effect late in the fiscal year, and thus for most of FY 2011, the UDAs were not subject to the newly required controls as appropriate to ensure that manual compensating controls are operating effectively. OFM plans to continue to assess its UDAs and to strengthen the controls associated with those UDAs.

Budgetary Resources. This process area continues to have a significant deficiency in FY 2011. The SEC continued its efforts to ensure the correct use of posting models and developed new policies and procedures related to posting obligations, funds reservations, and monitoring open obligations.

During FY 2011, the agency found continuing issues, specifically in the design and operation of controls to:

- Record obligations and adjustments to obligations accurately and on a timely basis, upon contract execution.
- Ensure completeness of recorded obligations between the core financial reporting and sub-ledger systems.
- Ensure that open obligations identified by the divisions and offices as no longer needed are timely de-obligated by the contracting officer per the closeout procedures contained in the Federal Acquisition Regulation.

The SEC will continue to refine its business processes in this area in FY 2012. Most notably, the agency's controls over budgetary resources will be significantly enhanced through integration of procurement and financial systems, which the agency aims to achieve as part of the migration to a Federal Shared Service Provider (FSSP).

Filing Fees. This process area continues to have a significant deficiency in FY 2011 related to timeliness of recording revenues and the backlog of inactive registrant accounts with balances. The agency moved on multiple fronts to remediate these deficiencies, such as eliminating a backlog of offering and verification reviews of fees, resolving thousands of registrant deposit accounts, and implementing a quarterly statistical

analysis to enhance the accuracy of financial reporting related to filing fees.

As of September 30, 2011, the control activities still need to be improved to routinely review, research, and monitor registrant deposit account activity to determine if amounts should be refunded or recognized as revenue. The processes for continuous monitoring and sustaining these efforts will be finalized and formalized in FY 2012.

The SEC will continue its efforts to resolve the backlog of inactive deposit accounts and maintain the timeliness of the review and verification of filing fees. In addition, the SEC will continue to develop and implement long term enhancements, such as business process redesign and enhancements to the systems supporting these processes. With these remediation efforts, the SEC intends to ensure that registrant filings and deposits are matched on a timely basis, revenues are recorded in the period earned, and there is no backlog of dormant registrant deposit accounts.

Financial Management System Conformance

The FFMA requires that each agency shall implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. The purpose of the FFMA is to advance Federal financial management by ensuring that financial management systems provide accurate, reliable, and timely financial management information. Although the SEC is exempt from the requirement to determine substantial compliance with FFMA, the agency assesses its financial management systems annually for conformance with the requirements of OMB Circular A-127 and other Federal financial system requirements.

The SEC's process for assessing its financial management systems is in compliance with the January 9, 2009 revision of OMB Circular A-127 and included the use of an FFMA risk model that ranks risks from nominal to significant. Based on the results of the review, the SEC concluded that its risk rating is nominal. After reviewing the criteria in OMB Circular A-127 for agencies with nominal risk, the SEC determined its financial core and mixed systems are in substantial compliance with Section 803(a) of the FFMA requirements. This decision was based on notable progress made in implementing corrective

actions in response to the material weakness in information systems noted in FY 2010.

Summary of Current Financial System and Future Strategies

The SEC's current financial management system environment is characterized by a core financial system that has some gaps in functionality; silo applications providing key financial management functionality; external data marts with embedded business logic used for reporting; and processes that rely extensively on human capital for data entry, cleansing, and reconciliation. The SEC's core financial system, Momentum Version 6.1.5, is used to record all accounting transactions, maintain an agency-wide general ledger, produce financial reports, and generate external reports submitted periodically to Treasury and other Federal entities. The core financial system has automated interfaces with mixed systems such as the Budget Planning and Performance Management System for budget formulation and execution; the Central Contractor Registry for SEC vendor information; FedTraveler for travel orders and vouchers; Fee Momentum for the agency's filing fees; and the Department of the Interior's payroll systems. The agency's financial reporting and processes are dependent upon a number of Microsoft Access databases, such as those related to disgorgements and penalties receivables, financial reporting and analysis, payments to harmed investors, and accounts payable accruals.

During FY 2011, the agency began its migration to an OMB-designated FSSP to replace its core financial system. Through this initiative, the SEC seeks to automate some manual, non-integrated financial sub-processes and adopt standard business and technology practices. Accordingly, during FY 2011, the SEC signed two Inter-Agency Agreements (IAA) with the Enterprise Service Center of the U.S. Department of Transportation (DOT) for the Planning and Requirements Gathering and the Implementation Phases of this migration. The SEC has worked throughout FY 2011 with the DOT FSSP team to develop detailed requirements in order to cut over to the new system in FY 2012.

Federal Information Security Management Act (FISMA)

FISMA requires Federal agencies to conduct annual assessments of their information security and privacy programs, to develop and implement remediation efforts for identified weaknesses and vulnerabilities, and to report compliance to OMB. The SEC's Office of the Inspector General (OIG), Chief Information Security Officer, and Privacy Officer are performing a joint review of the agency's compliance with FISMA requirements during 2011, and will submit the report to OMB on November 15, 2011, as required.

In FY 2011, OIT, in conjunction with system owners, completed assessment and authorization activities for 22 reportable systems, including annual assessments of systems such as the Momentum core financial system. As a result, the SEC has now assessed and authorized a total of 59 reportable systems in accordance with OMB policy and guidance from the National Institute of Standards and Technology (NIST). OIT also completed contingency testing on the majority of the SEC's authorized systems as part of several disaster recovery exercises.

OIT, in conjunction with system owners, completed 58 privacy reviews during FY 2011. The privacy reviews included Privacy Impact Assessments (PIA) on 14 required systems.

SEC's Financial Statements

FINANCIAL SECTION

This section of the Performance and Accountability Report contains the U.S. Securities and Exchange Commission's (SEC) financial statements, required supplementary information, financial statements for the Investor Protection Fund, and the related Independent Auditor's Report. Information presented here satisfies the financial reporting requirements of the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, Accountability of Tax Dollars Act of 2002, and Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).

The SEC prepares these statements in conformity with U.S. Generally Accepted Accounting Principles (GAAP) for the Federal Government and OMB Circular A-136, *Financial Reporting Requirements*.

The first portion of this section contains the Government Accountability Office's (GAO) audit opinion, followed by the SEC's response. Then, the section shows the principal financial statements for the SEC as a whole. The statements provide a comparison of Fiscal Year (FY) 2011 and FY 2010 information. The SEC prepares the following required financial statements

- Balance Sheet – presents, as of a specific time, amounts of future economic benefits owned or managed by the reporting entity exclusive of items subject to stewardship reporting (assets), amounts owed by the entity (liabilities), and amounts which comprise the difference (net position).
- Statement of Net Cost – presents the gross cost incurred by the reporting entity less any exchange revenue earned from its activities. The SEC also prepares a Statement of Net Cost by program to provide cost information at the program level.
- Statement of Changes in Net Position – reports the change in net position during the reporting period. Net position is affected by changes to Cumulative Results of Operations.
- Statement of Budgetary Resources – provides information about how budgetary resources were made available as well as their status at the end of the year.
- Statement of Custodial Activity – reports collection of non-exchange revenue for the Treasury General Fund. The SEC, as the collecting entity, does not recognize these collections as revenue. Rather, the agency accounts for sources and disposition of the collections as custodial activities on this statement.

The SEC does not have stewardship over resources or responsibilities for which supplementary stewardship reporting would be required.

Budgetary information aggregated for purposes of the Statement of Budgetary Resources is disaggregated for each of the SEC's major budget accounts and is presented as Required Supplementary Information.

The accompanying *Notes to the Financial Statements* provide a description of significant accounting policies as well as detailed information on select statement lines.

The second portion of this section contains stand alone, comparative financial statements and accompanying notes for the Investor Protection Fund as required by the Dodd-Frank Act. These statements include the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Budgetary Resources.

FINANCIAL SECTION

Message from the Chief Financial Officer



I am delighted to join Chairman Schapiro in presenting the SEC's Performance and Accountability Report (PAR) for fiscal year (FY) 2011. We hope you find the PAR a useful summary of the SEC's use of resources, operating performance, financial stewardship, and internal control.

I am extremely pleased to report that the SEC has successfully remediated the two material weaknesses identified in 2010 related to information systems and financial reporting and accounting processes. This was a top priority of the SEC, and I am gratified that the agency staff's hard work and dedication to building a strong internal control environment have yielded such significant results.

In FY 2011, the SEC significantly enhanced its technology security, thereby reducing the first material weakness in information systems down to a significant deficiency. The agency achieved this important milestone through efforts such as remediating self-identified security deficiencies, updating security patches on SEC systems, and strengthening user access controls. The SEC eliminated the second material weakness by resolving two of the five underlying significant deficiencies, in disgorgements and penalties and in required supplementary information, and making significant progress on the other three areas, related to financial reporting, budgetary

resources, and filing fees. The agency did so through efforts such as:

- Tightening controls over the recording of subsequent orders, post-judgment interest, and deposits in transit related to disgorgements and penalties;
- Eliminating a backlog of offering and verification reviews of fees paid on registrant filings, and significantly reducing the backlog of inactive registrant accounts;
- Redesigning and implementing controls over the spreadsheets and databases used by the agency for material financial reporting-related transactions and key operational management decisions, based on risk;
- Bolstering the processes related to the use of miscellaneous obligating documents; and
- Strengthening our process for de-obligating funds from completed contracts, and ensuring that appropriate accounting adjustments are recognized.

At the same time, the agency has been engaged in a multi-year effort to migrate its core financial system to a Federal Shared Service Provider (FSSP) model, engaging with the Department of Transportation's Enterprise Services Center (ESC). The ESC has successfully served multiple Federal agencies, including various components of the Department of Transportation, the Government Accountability Office, and the Commodity Futures Trading Commission. Through this initiative, the SEC will

realize improvements in system functionality, automate some manual processes, and further enhance financial management and reporting.

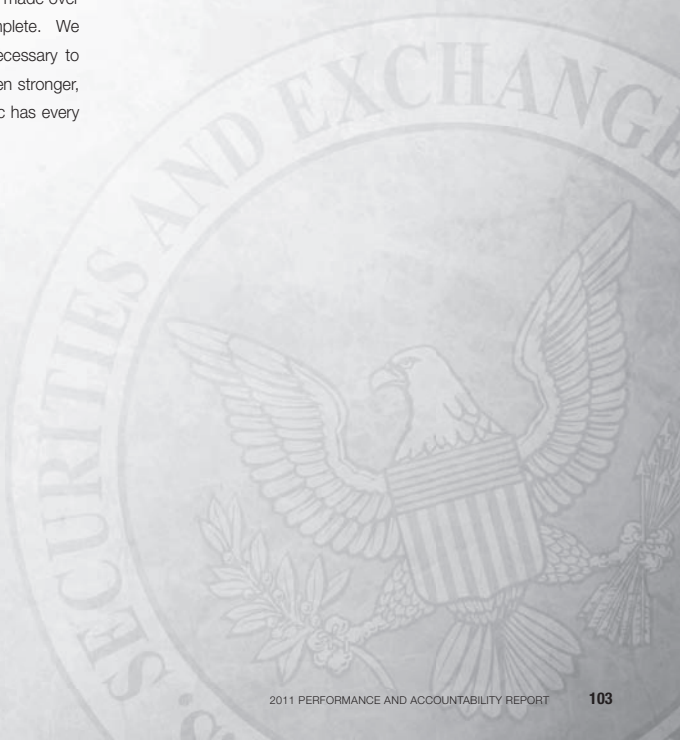
In FY 2012, the SEC will continue working to ensure a successful transition to the FSSP, and the agency is on track to cut over to the new system and associated new processes in that year. In addition, the SEC plans further progress on tightening information security, resolving the backlog of inactive registrant deposit accounts, bolstering the processes related to deobligations of previously executed contracts, and implementing controls over spreadsheets and databases related to financial reporting.

I am proud of the tremendous strides the SEC has made over the past year. Yet our work is certainly not complete. We will continue investing the time and resources necessary to remediate our remaining deficiencies and build even stronger, more sustainable controls. That is what the public has every right to expect from their government.

Sincerely,



Kenneth A. Johnson
Chief Financial Officer
November 15, 2011



FINANCIAL SECTION

Financial Statements

U.S. SECURITIES AND EXCHANGE COMMISSION

Balance Sheet

As of September 30, 2011 and 2010

(DOLLARS IN THOUSANDS)

	FY 2011	FY 2010
ASSETS (Notes 2 and 11):		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 6,995,610	\$ 6,989,367
Investments, Net (Note 5)	1,202,525	924,823
Accounts Receivable (Note 6)	20	-
Advances and Prepayments	7,172	2,198
Total Intragovernmental	8,205,327	7,916,388
Cash and Other Monetary Assets (Note 4)	-	2,815
Accounts Receivable, Net (Note 6)	214,026	161,143
Advances and Prepayments	3,656	2,381
Property and Equipment, Net (Note 7)	93,939	79,712
Total Assets	\$ 8,516,948	\$ 8,162,439
LIABILITIES (Notes 8 and 11):		
Intragovernmental:		
Accounts Payable	\$ 8,049	\$ 5,185
Employee Benefits	2,877	6,088
Unfunded FECA and Unemployment Liability	1,770	1,719
Custodial Liability	51,745	42,380
Liability for Non-Entity Assets	134	4
Total Intragovernmental	64,575	55,376
Accounts Payable	52,768	46,260
Accrued Payroll and Benefits	18,395	31,649
Accrued Leave	45,472	45,629
Registrant Deposits	46,622	44,729
Actuarial FECA Liability	7,805	7,576
Liability for Disgorgement and Penalties (Note 16)	862,976	1,021,466
Other Accrued Liabilities (Note 8)	7,212	29,270
Total Liabilities	1,105,825	1,281,955
Commitments and Contingencies (Note 10)		
NET POSITION (Note 11):		
Unexpended Appropriations – Other Funds	735	1,749
Cumulative Results of Operations – Earmarked Funds	7,409,186	6,878,132
Cumulative Results of Operations – Other Funds	1,202	603
Total Net Position	\$ 7,411,123	\$ 6,880,484
Total Liabilities and Net Position	\$ 8,516,948	\$ 8,162,439

The accompanying notes are an integral part of these financial statements.

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Net Cost

For the years ended September 30, 2011 and 2010

(DOLLARS IN THOUSANDS)

	FY 2011	FY 2010
PROGRAM COSTS (Note 12):		
Enforcement	\$ 391,183	\$ 355,451
Compliance Inspections and Examinations	239,435	229,389
Corporation Finance	131,660	131,166
Trading and Markets	62,176	54,107
Investment Management	47,240	47,873
Risk, Strategy and Financial Innovation	20,080	18,143
General Counsel	41,357	39,780
Other Program Offices	45,122	48,603
Agency Direction and Administrative Support	163,357	128,531
Inspector General	6,528	5,380
Total Program Costs	1,148,138	1,058,423
Less: Earned Revenue Not Attributed to Programs (Note 12)	1,643,730	1,382,856
Net (Income) Cost from Operations (Note 15)	\$ (495,592)	\$ (324,433)

The accompanying notes are an integral part of these financial statements.

FINANCIAL SECTION

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Changes in Net Position

For the years ended September 30, 2011 and 2010

	FY 2011		
(DOLLARS IN THOUSANDS)	Earmarked Funds	All Other Funds	Consolidated Total
CUMULATIVE RESULTS OF OPERATIONS:			
Beginning Balances	\$ 6,878,132	\$ 603	\$ 6,878,735
Budgetary Financing Sources:			
Appropriations Used	—	1,014	1,014
Non-Exchange Revenue	990	—	990
Other Financing Sources:			
Imputed Financing (Note 13)	34,380	—	34,380
Other	—	(323)	(323)
Total Financing Sources	35,370	691	36,061
Net Income (Cost) from Operations	495,684	(92)	495,592
Net Change	531,054	599	531,653
Cumulative Results of Operations (Note 11)	7,409,186	1,202	7,410,388
UNEXPENDED APPROPRIATIONS:			
Beginning Balances	—	1,749	1,749
Budgetary Financing Sources:			
Appropriations Used	—	(1,014)	(1,014)
Total Unexpended Appropriations	—	735	735
Net Position, End of Period	\$ 7,409,186	\$ 1,937	\$ 7,411,123
	FY 2010		
(DOLLARS IN THOUSANDS)	Earmarked Funds	All Other Funds	Consolidated Total
CUMULATIVE RESULTS OF OPERATIONS:			
Beginning Balances	\$ 6,058,225	\$ —	\$ 6,058,225
Budgetary Financing Sources:			
Appropriations Used	—	8,111	8,111
Non-Exchange Revenue	451,910	—	451,910
Other Financing Sources:			
Imputed Financing (Note 13)	36,216	—	36,216
Other	—	(160)	(160)
Total Financing Sources	488,126	7,951	496,077
Net Income (Cost) from Operations	331,781	(7,348)	324,433
Net Change	819,907	603	820,510
Cumulative Results of Operations (Note 11)	6,878,132	603	6,878,735
UNEXPENDED APPROPRIATIONS:			
Beginning Balances	—	9,860	9,860
Budgetary Financing Sources:			
Appropriations Used	—	(8,111)	(8,111)
Total Unexpended Appropriations	—	1,749	1,749
Net Position, End of Period	\$ 6,878,132	\$ 2,352	\$ 6,880,484

The accompanying notes are an integral part of these financial statements.

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Budgetary Resources

For the years ended September 30, 2011 and 2010

(DOLLARS IN THOUSANDS)

	FY 2011	FY 2010
BUDGETARY RESOURCES:		
Unobligated Balance, Brought Forward, October 1	\$ 489,349	\$ 26,765
Recoveries of Prior Year Unpaid Obligations	38,945	18,753
Budget Authority:		
Appropriation	(847)	451,910
Spending Authority from Offsetting Collections:		
Earned:		
Collected	1,598,067	1,443,347
Change in Receivables from Federal Sources	20	(188)
Change in Unfilled Customer Orders:		
Advance Received	–	(157)
Without Advance from Federal Sources	2	(98)
Subtotal	1,597,242	1,894,814
Temporarily not Available Pursuant to Public Law	(412,005)	(347,694)
Total Budgetary Resources	\$ 1,713,531	\$ 1,592,638
STATUS OF BUDGETARY RESOURCES:		
Obligations Incurred:		
Direct (Note 14)	\$ 1,215,144	\$ 1,103,007
Direct, Change in Legal Interpretation for Lease Obligations (Note 14)	777,928	–
Reimbursable (Note 14)	388	282
Subtotal	1,993,460	1,103,289
Unobligated Balance:		
Apportioned	459,248	17,213
Unobligated Balance Not Available	(739,177)	472,136
Total Status of Budgetary Resources	\$ 1,713,531	\$ 1,592,638
CHANGE IN OBLIGATED BALANCE:		
Obligated Balance, Net:		
Unpaid Obligations, Brought Forward, October 1	\$ 317,772	\$ 236,399
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(25)	(311)
Total Unpaid Obligated Balance, Net, Beginning of Fiscal Year	317,747	236,088
Obligations Incurred Net	1,993,460	1,103,289
Gross Outlays	(1,161,653)	(1,003,163)
Recoveries of Prior Year Unpaid Obligations, Actual	(38,945)	(18,753)
Change in Uncollected Customer Payments from Federal Sources	(22)	286
Total, Unpaid Obligated Balance, Net, End of Period (Note 10)	\$ 1,110,587	\$ 317,747
Obligated Balance, Net, End of Period:		
Unpaid Obligations	1,110,634	317,772
Uncollected Customer Payments from Federal Sources	(47)	(25)
Total, Unpaid Obligated Balance, Net, End of Period (Note 10)	\$ 1,110,587	\$ 317,747
NET OUTLAYS:		
Net Outlays:		
Gross Outlays	\$ 1,161,653	\$ 1,003,163
Offsetting Collections	(1,598,067)	(1,443,190)
Distributed Offsetting Receipts	660	194
Net Outlays/(Collections)	\$ (435,754)	\$ (439,833)

The accompanying notes are an integral part of these financial statements.

FINANCIAL SECTION

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Custodial Activity

For the years ended September 30, 2011 and 2010

(DOLLARS IN THOUSANDS)

	FY 2011	FY 2010
REVENUE ACTIVITY:		
Sources of Cash Collections:		
Disgorgement and Penalties	\$ 413,413	\$ 1,116,632
Other	8,109	1
Total Cash Collections	421,522	1,116,633
Accrual Adjustments	9,365	42,380
Total Custodial Revenue	430,887	1,159,013
DISPOSITION OF COLLECTIONS:		
Amounts Transferred to:		
Department of the Treasury	421,522	664,723
Investor Protection Fund	—	451,910
Amounts Yet to be Transferred	9,365	42,380
Total Disposition of Collections	430,887	1,159,013
NET CUSTODIAL ACTIVITY	\$ —	\$ —

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

U.S. SECURITIES AND EXCHANGE COMMISSION
As of September 30, 2011 and 2010

NOTE 1. Summary of Significant Accounting Policies

A. Reporting Entity

The Securities and Exchange Commission (SEC) is an independent agency of the U.S. Government established pursuant to the Securities Exchange Act of 1934 (Exchange Act), charged with regulating this country's capital markets. The SEC's mission is to protect investors; maintain fair, orderly, and efficient securities markets; and facilitate capital formation. The SEC works with Congress, other executive branch agencies, Self Regulatory Organizations (SROs) (e.g., securities exchanges and the Financial Industry Regulatory Authority (FINRA)), accounting and auditing standards setters, state securities regulators, law enforcement officials, and many other organizations in support of the agency's mission.

The agency's programs protect investors and promote the public interest by fostering and enforcing compliance with the Federal securities laws; establishing an effective regulatory environment; facilitating access to the information investors need to make informed investment decisions; and enhancing the SEC's performance through effective alignment and management of human, information, and financial capital.

The SEC consists of five presidentially-appointed Commissioners, with staggered five-year terms. The SEC is organized into five Divisions and multiple offices. The five divisions are the Division of Corporation Finance; the Division of Trading and Markets; the Division of Investment Management; the Division of Enforcement; and the Division of Risk, Strategy, and Financial Innovation. The offices include the Office of Administrative Law Judges, the Office of Compliance Inspections and Examinations, the Office of the Chief Accountant, Office of Investor Education and Advocacy and various supporting services.

The SEC reporting entity includes the Investor Protection Fund (See Note 1.T. *Investor Protection Fund*). As discussed in Note 10.A. *Commitments: Securities Investor Protection Act*, the SEC reporting entity does not include the Securities Investor Protection Corporation (SIPC).

As discussed at Note 1.S. *Disgorgement and Penalties*, disgorgement funds collected and held by the SEC on behalf of harmed investors are part of the SEC reporting entity. However, disgorgement funds held by the U.S. Courts and by non-Federal receivers on behalf of harmed investors are not part of the SEC reporting entity.

B. Basis of Presentation and Accounting

The accompanying financial statements present the financial position, net cost of operations, changes in net position, budgetary resources, and custodial activities of the SEC's core business activities as required by the Accountability of Tax Dollars Act of 2002. The statements may differ from other financial reports submitted pursuant to Office of Management and Budget (OMB) directives for the purpose of monitoring and controlling the use of the SEC budgetary resources, due to differences in applicable accounting and reporting principles discussed in the following paragraphs. The SEC's books and records serve as the source of the information presented in the accompanying financial statements.

The agency classifies assets, liabilities, revenues, and costs in these financial statements according to the type of entity associated with the transactions. Intragovernmental assets and liabilities are those due from or to other Federal entities. Intragovernmental revenues are earned from other Federal entities. Intragovernmental costs are payments or accruals due to other Federal entities.

The SEC's financial statements are prepared in conformity with generally accepted accounting principles (GAAP) for the Federal Government and presented in conformity with OMB Circular A-136, *Financial Reporting Requirements*. The Balance Sheet, Statement of Net Cost and Statement of Changes in Net Position are prepared using the accrual basis of accounting. Accordingly, revenues are recognized when earned and expenses are recognized when incurred without regard to the receipt or payment of cash. These principles differ from budgetary accounting and reporting principles on

FINANCIAL SECTION

which the Statement of Budgetary Resources is prepared. The differences relate primarily to the capitalization and depreciation of property and equipment, as well as the recognition of other long-term assets and liabilities. The Statement of Custodial Activity is presented on the modified cash basis of accounting. Cash collections and amounts transferred to Treasury or the Investor Protection Fund are reported on a cash basis. The change in receivables and related payables are reported on an accrual basis.

The SEC presents net cost of operations by program. OMB Circular A-136 defines the term "major program" as describing an agency's mission, strategic goals, functions, activities, services, projects, processes, or any other meaningful grouping. The presentation by program is consistent with the presentation used by the agency in submitting its budget requests.

Certain FY 2010 balances in the footnotes to the financial statements have been reclassified to conform to FY 2011 presentations.

C. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. These estimates and assumptions include, but are not limited to, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are also used in the allocation of costs to the SEC programs presented in the Statement of Net Cost. Actual results may differ from those estimates.

D. Intra- and Inter-Agency Relationships

The SEC is comprised of a single Federal agency with limited intra-entity transactions. The Investor Protection Fund, which was created in FY 2010, finances the operations of the SEC Office of the Inspector General's employee suggestion program on a reimbursable basis. This has given rise to a small amount of intra-entity eliminations of the related revenue and expense transactions between the Investor Protection Fund and the SEC's General Salaries and Expenses Fund.

E. Fund Accounting Structure

The SEC, in common with other Federal agencies, utilizes various Treasury Appropriation Fund Symbols (Funds), to recognize and track appropriation authority provided by Congress, collections from the public and other financial activity. These funds are described below:

- (1) **General Funds – Salaries and Expenses:** Earned revenues from securities transaction fees from SROs and securities registration, tender offer, merger, and other fees from registrants are deposited into Fund X0100, *Salaries and Expenses, Securities and Exchange Commission*. These collections are earmarked for carrying out the SEC's mission, functions, and day to day operations and may be used in accordance with spending limits established by Congress. Collections in excess of Congressional spending limits are unavailable by law and reported as Non-Budgetary Fund Balance with Treasury (See *Note 3. Fund Balance with Treasury*). In this context, "earmarked" indicates that these collections are set aside by Congress for the purpose stated. In addition, the SEC received a supplemental appropriation of \$10 million for use in FY 2009 and FY 2010.
- (2) **Deposit Funds:** The Deposit Funds hold disgorgement, penalties, and interest collected and held on behalf of harmed investors, registrant monies held temporarily until earned by the SEC, and collections awaiting disposition or reclassification. This activity is recognized in Fund X6561, *Unearned Fees, Securities and Exchange Commission* and Fund X6563, *Disgorgement and Penalty Amounts Held for Investors, Securities and Exchange Commission*.
- (3) **Miscellaneous Receipt Accounts:** The Miscellaneous Receipt Accounts hold non-entity receipts and accounts receivable from custodial activities that the SEC cannot deposit into funds under its control. These accounts include receipts pursuant to certain SEC enforcement actions and other small collections that will be sent to the U.S. Treasury General Fund upon collection. This activity is recognized in Fund 1060, *Forfeitures of Unclaimed Money and Property*, Fund 1099, *Fines, Penalties, and Forfeitures, Not Otherwise Classified*, Fund 1435, *General Fund Proprietary Interest, Not*

Otherwise Classified, and Fund 3220, *General Fund Proprietary Receipts, Not Otherwise Classified*.

(4) Investor Protection Fund: The Investor Protection Fund is an earmarked fund that provides dedicated funding for the whistleblower awards as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Persons may receive award payments from the Fund if they provide original information to the SEC that results in a successful enforcement action and other conditions are met. In addition, the Fund is used to finance the operations of the SEC Office of the Inspector General's employee suggestion program for the receipt of suggestions for improvements in work efficiency and effectiveness, and allegations of misconduct or mismanagement within the SEC. This activity is recognized in Fund X5567, *Monetary Sanctions and Interest, Investor Protection Fund, Securities and Exchange Commission (Investor Protection Fund)*.

(5) Reserve Fund: Effective October 1, 2011, a portion of SEC registration fee collections up to \$50 million in any one fiscal year may be deposited in the Reserve Fund, the balance of which cannot exceed \$100 million. The Reserve Fund may be used by the SEC to obligate amounts up to a total of \$100 million in one fiscal year as the SEC determines necessary to carry out its functions. The SEC must notify Congress after obligating amounts from the Reserve Fund. The SEC established the Fund in FY 2011 in anticipation of beginning Reserve Fund operations in FY 2012.

The SEC's lending and borrowing authority is limited to authority to borrow funds from Treasury and loan funds to SIPC, as discussed in *Note 10. Commitments and Contingencies*. The SEC has custodial responsibilities, as disclosed in *Note 1.M. Liabilities*.

F. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. The SEC collects earmarked funds and is required to use these funds for designated activities, benefits or purposes and to account for

them separately from the Government's general revenues. The SEC's earmarked funds include securities transaction fees from SROs and securities registration, tender offer, merger, and other fees from registrants. These are reported as offsetting collections as defined by OMB and are deposited into Fund X0100, *Salaries and Expenses*. Also, all funds held in the Fund X5567, *Investor Protection Fund*, are considered earmarked as described in *Note 11. Earmarked, Other Entity, Disbursement and Penalties, and Other Non-Entity Funds*.

G. Entity and Non-Entity Assets

Entity assets are assets that the SEC may use in its operations. This includes amounts where SEC management has the authority to decide how funds will be used as well as other amounts that the SEC is legally obligated to use to meet program obligations.

Assets that an agency holds on behalf of another Federal agency or a third party and are not available for the agency's use are non-entity assets. The SEC's non-entity assets include the following: (i) disgorgement, penalties, and interest collected and held or invested by the SEC; (ii) disgorgement, penalties, and interest receivable; (iii) accounts receivable with respect to Freedom of Information Act (FOIA) fees; and (iv) excess filing fees remitted by registrants (registrant deposits).

H. Fund Balance with Treasury

Fund Balance with Treasury (FBWT) reflects amounts the SEC holds in the U.S. Treasury that have not been invested in Federal securities. The SEC's FBWT consist of several components.

- (1) The aggregate amount of funds in the SEC's general fund accounts with Treasury that the SEC is authorized to use to make expenditures and pay liabilities;
- (2) Filing and securities transaction fees in excess of appropriated amounts;
- (3) Funds held in the Investor Protection Fund;
- (4) Registrant deposits held pending submission of a filing or return to the registrant; and
- (5) Disgorgement funds held on behalf of harmed investors

FINANCIAL SECTION

The SEC conducts all of its banking activity in accordance with directives issued by Treasury's Financial Management Service.

I. Investments

The SEC has the authority to invest disgorgement funds in Treasury securities including civil penalties collected under the "Fair Fund" provision of the Sarbanes-Oxley Act of 2002. As the funds are collected, the SEC holds them in a deposit fund account and may invest them in overnight and short-term market-based Treasury bills through the Bureau of the Public Debt. The SEC adds interest earned to the funds, and these funds are subject to taxation under Treasury Regulation Section 1.468B-2.

The SEC also has authority to invest amounts in the Investor Protection Fund in overnight and short-term market-based Treasury bills through the Bureau of the Public Debt. The interest earned on the investments is a component of the balance of the Fund and available to be used for expenses of the Investor Protection Fund.

Additional details regarding SEC investments are provided in *Note 5. Investments, Net*.

Intragovernmental Investments in Treasury Securities

Market-based Treasury securities are debt securities that the U.S. Treasury issues to Federal entities without statutorily determined interest rates. Although the securities are not marketable, the terms (prices and interest rates) mirror the terms of marketable Treasury securities.

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with the investment by Federal agencies in non-marketable Federal securities. The balances underlying these investments are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to the SEC as evidence of these balances. Treasury securities are an asset of the SEC and a liability of the U.S. Treasury. Because the SEC and the U.S. Treasury are both components of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole.

For this reason, the investments presented by the SEC do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the SEC with authority to draw upon the U.S. Treasury to make future payments from these accounts. When the SEC requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same manner in which the Government finances all expenditures.

J. Accounts Receivable and Allowance for Uncollectible Accounts

SEC's entity and non-entity accounts receivable consist primarily of amounts due from the public. Entity accounts receivable are amounts that the SEC may retain upon collection. Non-entity accounts receivable are amounts that the SEC will forward to another Federal agency or to the public upon collection.

Entity Accounts Receivable

The bulk of SEC entity accounts receivable arise from securities transaction fees and from filing fees paid by registrants. In addition, the SEC has small amounts of activity arising from the sale of goods or services provided by the SEC to other Federal agencies; reimbursement of employee travel by outside organizations; and employee-related debt. Entity accounts receivable balances are normally small at year end due to the timing and payment requirements relative to the largest categories of accounts receivable activity. Specifically, Federal law generally requires payment of filing fees at the time of filing, and securities transaction fees are payable to the SEC twice a year: in March for the period September through December, and in September for the period January through August. Accordingly, the year-end accounts receivable accrual generally represents fees payable to the SEC for one month of securities transaction fee activity (September). At the end of the first, second and third quarters, the receivable reflects four months, three months, and six months of securities transaction fee activity, respectively.

Non-entity Accounts Receivable

Non-entity accounts receivable arise mainly from amounts assessed against violators of securities laws, including disgorgement of illegal gains, civil penalties, and related assessed interest. The SEC is responsible for collection, and recognizes a receivable, when an order of the Commission or a Federal court directs payment to the SEC or the U.S. Treasury.

Interest recognized by the SEC on non-entity accounts receivable includes prejudgment interest specified by the court or administrative order as well as post-judgment interest on collectible accounts. The SEC does not recognize interest revenue on accounts considered to be uncollectible.

The SEC is also party to court orders directing violators of Federal securities laws to pay amounts assessed to a Federal court or to a non-Federal receiver acting on behalf of harmed investors. These orders are not recognized as accounts receivable by the SEC because the debts are payable to, and collected by, another party.

Allowance for Uncollectible Amounts

The SEC calculates the allowance for uncollectible amounts and the related provision for estimated losses for filing fees and other accounts receivable using an analysis of historical collection data. No allowance for uncollectible amounts or related provision for estimated losses has been established for securities transaction fees payable by SROs, as these amounts are fully receivable based on historical experience.

The SEC uses a three-tiered methodology to calculate the allowance for loss on its non-entity disgorgement and penalty accounts receivable balances. The first tier involves making an individual collection assessment of the cases constituting the top 90 percent of the value of the disgorgement and penalty accounts receivable portfolio. The second and third tiers are composed of cases in the bottom 10 percent of the value. Separate calculations are performed on accounts that are equal to or less than 30 days old and accounts that are over 30 days old using an allowance rate based on historical collection data.

The SEC writes off receivables aged two or more years by removing the debt amounts from the gross accounts receivable and any related allowance for uncollectible accounts.

K. Other Assets**Advances and Prepayments**

Payments made in advance of the receipt of goods and services are recorded as advances or prepayments, and recognized as expenses when the related goods and services are received.

L. Property and Equipment, Net

The SEC's property and equipment consists of software, general-purpose equipment used by the agency, capital improvements made to buildings leased by the SEC for office space, and, when applicable, internal-use software development costs for projects in development. The SEC reports property and equipment purchases and additions at historical cost. The agency expenses property and equipment acquisitions that do not meet the capitalization criteria as well as normal repairs and maintenance.

The SEC depreciates property and equipment over the estimated useful lives using the straight-line method of depreciation. The agency removes property and equipment from its asset accounts in the period of disposal, retirement, or removal from service. The SEC recognizes the difference between the book value and the proceeds as a gain or loss in the period that the asset is removed.

M. Liabilities

The SEC recognizes liabilities for probable future outflows or other sacrifices of resources as a result of events that have occurred as of the Balance Sheet date. The SEC's liabilities consist of routine operating accounts payable, accrued payroll and benefits, registrant deposit accounts that have not been returned to registrants, liabilities for disgorgement and penalties, legal liabilities, and custodial liabilities for amounts collected or receivable on behalf of Treasury.

Enforcement Related Liabilities

A liability for disgorgement and penalties arises when an order is issued for the SEC to collect disgorgement, penalties, and interest from securities law violators. When the Commission or court issues such an order, the SEC establishes an accounts receivable due to the SEC offset by a liability. The presentation

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of this liability on the Balance Sheet is dependent upon several factors. If the court or Commission order indicates that collections are to be retained by the Federal Government, either by transfer to the U.S. Treasury General Fund or to the Investor Protection Fund, the liabilities are classified as custodial (that is, collected on behalf of the Government) and intra-governmental. If the order indicates that the funds are eligible for distribution to harmed investors, the SEC will recognize a Governmental liability (that is, a liability of the Government to make a payment to the public). This liability is not presented as a custodial liability. The SEC does not record liabilities on its financial statements for disgorgement and penalty amounts that another government entity such as a court, or a non-governmental entity, such as a receiver, has collected or will collect.

Prior to the enactment of the Dodd-Frank Act on July 21, 2010, all collections not distributed to harmed investors were transferred to the U.S. Treasury General Fund. After the enactment of the Dodd-Frank Act, collections not distributed to harmed investors may be transferred to either the Investor Protection Fund or the U.S. Treasury General Fund. Collections not distributed to harmed investors are transferred to the Investor Protection Fund if the Fund's balance does not exceed \$300 million at the time of collection.

Liability Classification

The SEC recognizes liabilities covered by three types of resources: realized budgetary resources, unrealized budgetary resources that become available without further congressional action, and amounts that do not require the use of current budgetary resources. Realized budgetary resources include obligated balances that fund existing liabilities and unobligated balances as of the relevant Balance Sheet dates. Unrealized budgetary resources represent fee collections in excess of amounts appropriated for current fiscal year spending. The SEC uses these resources to cover liabilities when appropriation language makes these unrealized budgetary resources available in the fiscal year without further congressional action. Amounts that do not require the use of current budgetary resources are liabilities that will be funded in future years, such as annual leave.

N. Employee Retirement Systems and Benefits

The SEC's employees may participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS), depending on when they started working for the Federal Government. Pursuant to Public Law 99-335, FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees who are rehired after a break in service of more than one year and who had five years of Federal civilian service prior to 1987 are eligible to participate in the CSRS offset retirement system or may elect to join FERS.

All employees are eligible to contribute to a Thrift Savings Plan (TSP). For those employees participating in FERS, the TSP is automatically established, and the SEC makes a mandatory one percent contribution to this plan. In addition, the SEC matches contributions ranging from one to four percent for FERS-eligible employees who contribute to their TSP. The SEC contributes a matching amount to the Social Security Administration under the Federal Insurance Contributions Act, which fully covers FERS participating employees. Employees participating in CSRS do not receive matching contributions to their TSP.

The SEC does not report CSRS, FERS, Federal Employees Health Benefits Program (FEHBP), Federal Employees Group Life Insurance Program (FEGSIP) assets, accumulated plan benefits, or unfunded liabilities applicable to its employees; the U.S. Office of Personnel Management (OPM) reports this information.

O. Injury and Post-employment Compensation

The Federal Employees' Compensation Act (FECA), administered by the U.S. Department of Labor (DOL), provides income and medical cost protection to covered Federal civilian employees harmed on the job or who have contracted an occupational disease, and dependents of employees whose death is attributable to a job-related injury or occupational disease. The DOL bills the SEC annually as claims are paid, and the SEC in turn accrues a liability to recognize the future payments. Payment on these bills is deferred for two years to allow for funding through the budget process. Similarly, employees that the SEC terminates without cause may receive unemployment compensation benefits under the

unemployment insurance program also administered by the DOL, which bills each agency quarterly for paid claims.

In addition, the SEC records an estimate for the FECA actuarial liability using the DOL's FECA model. The model considers the average amount of benefit payments incurred by the SEC for the past three fiscal years, multiplied by the medical and compensation liability to benefits paid (LBP) ratio for the whole FECA program.

P. Annual, Sick, and Other Leave

The SEC accrues annual leave and compensatory time as earned and reduces the accrual when leave is taken. The balances in the accrued leave accounts reflect current leave balances and pay rates. No portion of this liability has been obligated. Future financing sources provide funding to the extent that current or prior year funding is not available to pay for leave earned but not taken. The SEC expenses sick leave and other types of non-vested leave as used.

Q. Revenue and Other Financing Sources

The SEC's revenue and financing sources include exchange revenues, which are generated from arm's-length transactions in which both parties give and receive value, and non-exchange revenues, which arise from the Government's ability to demand payment.

Exchange Revenue

The SEC's exchange revenue consists primarily of collections of securities transaction fees from SROs and of securities registration, tender offer, merger, and other fees from registrants. The fee rates are calculated by the SEC's Division of Risk, Strategy, and Financial Innovation and established by the SEC in accordance with Federal law and are applied to volumes of activity reported by SROs or to filings submitted by registrants. Fees are recognized as exchange revenue on the effective date of transaction or filing. These fee collections are the primary source of SEC funding and may be used up to limits established by Congress. See *Note 1.E. Fund Accounting Structure*.

The SEC recognizes amounts remitted by registrants in advance of the transaction or filing date as a liability until earned by the SEC or returned to the registrant. Federal

regulation requires the return of registrant deposits when an account is dormant for three years.

Filing Fee Offsets

The Securities Act of 1933 and the Exchange Act do not permit refunds to registrants for securities that remain unsold after the completion, termination, or withdrawal of an offering. However, Code of Federal Regulations (CFR) Title 17 Chapter II, Part 230, Section 457(p) permits filers to offset a fee paid (filing fee offset) for a subsequent registration statement (offering) filed within five years of the initial filing date of the earlier registration statement. The total aggregate dollar amount of the filing fee associated with the unsold securities may be offset against the total filing fee due on the subsequent offering. Unused filing fee offsets are not a liability to the SEC because registrants cannot obtain refunds of fees or additional services in relation to securities that remain unsold. However, filing fee offsets may reduce revenue earned in future accounting periods.

Non-exchange Revenue

The SEC's non-exchange revenue mainly consists of amounts collected from violators of securities laws as a result of enforcement proceedings. These amounts may take the form of disgorgement of illegal gains, civil penalties, and related interest. Amounts collected may be paid to injured investors, transferred to the Investor Protection Fund, or transferred to the U.S. Treasury General Fund, based on established policy and regulation.

All non-exchange revenue expected to be forwarded to either the U.S. Treasury General Fund or Investor Protection Fund is recognized on the Statement of Custodial Activity. The Investor Protection Fund recognizes non-exchange revenue on the Statement of Changes in Net Position when funds are transferred into the Investor Protection Fund. The result is that, in accordance with Federal accounting standards, the entire amount of custodial activity is presented on the Statement of Custodial Activity to document the movement of funds and the portion retained by the SEC is also recognized as SEC activity.

The SEC does not recognize amounts collected and held by another government entity, such as a court registry, or a non-government entity, such as a receiver.

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R. Budgets and Budgetary Accounting

The SEC is subject to certain restrictions on its use of statutory fees. The SEC deposits all fee revenues in a designated account at Treasury. However, the SEC may use funds from this account only as authorized by Congress and made available by OMB apportionment, upon issuance of a Treasury warrant. Revenue collected in excess of appropriated amounts is restricted from use by the SEC.

The SEC can use fees other than the restricted excess fees from its operations, subject to annual congressional limitations, which were \$1,185 million and \$1,095 million for the budgets for FY 2011 and FY 2010, respectively. In addition, the SEC had available approximately \$36.1 million and \$16.1 million from prior year balances for FY 2011 and FY 2010, respectively. Funds appropriated that the SEC does not use in a given fiscal year are maintained in a designated account for use in future periods in accordance with the appropriation requirements. As previously mentioned in *Note 1.E. Fund Accounting Structure*, the SEC received a supplemental appropriation for \$10 million from the U.S. Treasury General Fund for use in FY 2009 and FY 2010. Unlike the annual appropriation, the supplemental funds are not offset by fees collected by the SEC.

General Funds – Salaries and Expenses

Each fiscal year, the SEC receives Category A apportionments, which are quarterly distributions of budgetary resources made by OMB. The SEC also receives a small amount of Category B funds for reimbursable activity, which are exempt from quarterly apportionment.

Investor Protection Fund

The Investor Protection Fund is a special fund that has the authority to retain revenues and other financing sources not used in the current period for future use. The Dodd-Frank Act provides that the Fund is available to the SEC without further appropriation or fiscal year limitation for the purpose of paying awards to whistleblowers and funding the activities of the Office of the Inspector General's employee suggestion program. However, the SEC is required to request

and obtain an annual apportionment from OMB to use these funds. All of the funds are Category B, exempt from quarterly apportionment.

S. Disgorgement and Penalties

The SEC maintains non-entity assets related to disgorgements and penalties ordered pursuant to civil injunctive and administrative proceedings. The SEC also recognizes an equal and offsetting liability for these assets as discussed in *Note 1.M. Liabilities*. These non-entity assets consist of disgorgement, penalties, and interest assessed against securities law violators where the Commission, administrative law judge, or in some cases, a court, has determined that the SEC should return such funds to harmed investors or may be transferred to the Investor Protection Fund or the U.S. Treasury General Fund. The SEC does not record on its financial statements any asset amounts that another government entity such as a court, or a non-governmental entity, such as a receiver, has collected or will collect. Additional details regarding disgorgement and penalties are presented in *Note 11. Earmarked, Other Entity, Disgorgement and Penalties, and Other Non-Entity Funds* and *Note 16. Disgorgement and Penalties*.

T. Investor Protection Fund

The Investor Protection Fund was established through a permanent indefinite appropriation to provide financing for payments to whistleblowers and for the SEC Office of the Inspector General's employee suggestion program. The Investor Protection Fund is financed by transferring a portion of monetary sanctions collected by the SEC in judicial or administrative actions brought by the SEC under the securities laws that are not added to disgorgement fund or other funds intended for harmed investors under Section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246). Sanctions collected by the Commission payable either to the SEC or the U.S. Treasury General Fund will be transferred to the Investor Protection Fund if the balance in that fund is less than \$300 million on the day of collection.

The SEC may request the Secretary of the Treasury to invest Investor Protection Fund amounts in Treasury obligations. Refer to *Note 1.I. Investments* for additional details.

NOTE 2. Assets

At September 30, 2011, SEC assets consisted of the following:

(DOLLARS IN THOUSANDS)	Entity	Non-Entity	Total
Intragovernmental:			
Fund Balance with Treasury:			
SEC Funds	\$ 6,875,059	\$ —	\$ 6,875,059
Registrant Deposits	—	46,622	46,622
Disgorgement and Penalties (Note 16)	—	73,929	73,929
Investments, Net:			
Disgorgement and Penalties (Note 16)	—	749,810	749,810
Investor Protection Fund	452,715	—	452,715
Accounts Receivable	20	—	20
Advances and Prepayments	7,172	—	7,172
Total Intragovernmental Assets	7,334,966	870,361	8,205,327
Cash and Other Monetary Assets:			
Disgorgement and Penalties (Note 16)	—	—	—
Accounts Receivable, Net:			
SEC Funds	122,910	—	122,910
Disgorgement and Penalties (Note 16)	—	90,982	90,982
Other Non-Entity Assets	—	134	134
Advances and Prepayments	3,656	—	3,656
Property and Equipment, Net (Note 7)	93,939	—	93,939
Total Assets (Note 11)	\$ 7,555,471	\$ 961,477	\$ 8,516,948

At September 30, 2010, SEC assets consisted of the following:

(DOLLARS IN THOUSANDS)	Entity	Non-Entity	Total
Intragovernmental:			
Fund Balance with Treasury:			
SEC Funds	\$ 6,890,369	\$ —	\$ 6,890,369
Registrant Deposits	—	44,729	44,729
Disgorgement and Penalties (Note 16)	—	54,269	54,269
Investments, Net:			
Disgorgement and Penalties (Note 16)	—	924,823	924,823
Investor Protection Fund	—	—	—
Accounts Receivable	—	—	—
Advances and Prepayments	2,198	—	2,198
Total Intragovernmental Assets	6,892,567	1,023,821	7,916,388
Cash and Other Monetary Assets:			
Disgorgement and Penalties (Note 16)	—	2,815	2,815
Accounts Receivable, Net:			
SEC Funds	79,200	—	79,200
Disgorgement and Penalties (Note 16)	—	81,939	81,939
Other Non-Entity Assets	—	4	4
Advances and Prepayments	2,381	—	2,381
Property and Equipment, Net (Note 7)	79,712	—	79,712
Total Assets (Note 11)	\$ 7,053,860	\$ 1,108,579	\$ 8,162,439

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NOTE 3. Fund Balance with Treasury

The Fund Balance with Treasury by type of fund and Status of Fund Balance with Treasury as of September 30, 2011 and 2010 consists of the following:

<i>(DOLLARS IN THOUSANDS)</i>	FY 2011	FY 2010
Fund Balances:		
General Funds	\$ 6,874,986	\$ 6,438,459
Special Fund – Investor Protection Fund	73	451,910
Other Funds	120,551	98,998
Total Fund Balance with Treasury	\$ 6,995,610	\$ 6,989,367
Status of Fund Balance with Treasury:		
Unobligated Balance:		
Available	\$ 8,323	\$ 17,213
Unavailable	38,751	472,136
Obligated Balance not Yet Disbursed	332,707	317,747
Non-Budgetary Fund Balance with Treasury	6,615,829	6,182,271
Total Fund Balance with Treasury	\$ 6,995,610	\$ 6,989,367

The Special Fund consists of the Investor Protection Fund established in FY 2010. This Special Fund provides the financial resources for the whistleblower award program and the SEC Office of Inspector General's employee suggestion program, both of which were mandated in the Dodd-Frank Act.

Other Funds consist of Fund Balance with Treasury held in deposit funds.

Obligated and unobligated balances reported for the status of Fund Balance with Treasury differ from the amounts reported in the Statement of Budgetary Resources due to the fact that budgetary balances are supported by amounts other than Fund Balance with Treasury. These amounts include Investor Protection Fund investments, uncollected payments from Federal sources, and the impact of the change in legal interpretation for leases.

Non-Budgetary Fund Balance with Treasury is comprised of amounts in deposit funds and offsetting collections temporarily precluded from obligation in SEC's General Salaries and Expenses Fund (X0100). Amounts temporarily precluded from obligation represent offsetting collections for filing and securities transaction fees in excess of appropriated amounts.

There were no significant differences between the Fund Balance reflected in SEC financial statements and the balance in the Treasury accounts.

NOTE 4. Cash and Other Monetary Assets

The SEC did not have a Cash balance as of September 30, 2011. The SEC receives disgorgement and penalties collections throughout the year. Any collections received after the Treasury Department cut-off for deposit of checks are treated as deposits in transit and recognized as Cash on the Balance Sheet. The SEC had a Cash balance of \$2.8 million as of September 30, 2010.

NOTE 5. Investments, Net

The SEC invests funds in overnight and short-term non-marketable market-based Treasury bills. The SEC records the value of its investments in Treasury bills at cost and amortizes any premium or discount on a straight-line basis (S/L) through the maturity date of these securities. Non-marketable market-based Treasury securities are issued by the Bureau of Public Debt to Federal agencies. They are not traded on any securities exchange but mirror the prices of similar Treasury securities trading in the Government securities market.

At September 30, 2011, investments consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investment, Net	Market Value Disclosure
Non-Marketable Market-Based Securities						
Disgorgement and Penalties	\$ 749,705	S/L	\$ 105	\$ —	\$ 749,810	\$ 749,848
Investor Protection Fund – Entity	453,799	S/L	(2,314)	1,230	452,715	451,696
Total	\$ 1,203,504		\$ (2,209)	\$ 1,230	\$ 1,202,525	\$ 1,201,544

At September 30, 2010, investments consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investment, Net	Market Value Disclosure
Non-Marketable Market-Based Securities						
Disgorgement and Penalties	\$ 924,651	S/L	\$ 171	\$ 1	\$ 924,823	\$ 924,837
Investor Protection Fund – Entity	—	S/L	—	—	—	—
Total	\$ 924,651		\$ 171	\$ 1	\$ 924,823	\$ 924,837

NOTE 6. Accounts Receivable, Net

At September 30, 2011, accounts receivable consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Gross Receivables	Allowance	Net Receivables
Intragovernmental Entity Accounts Receivable:			
Reimbursable Activity	\$ 20	\$ —	\$ 20
Subtotal Intragovernmental Accounts Receivable	20	—	20
Entity Accounts Receivable:			
Securities Transaction Fees	121,798	—	121,798
Filing Fees	893	109	784
Other	375	47	328
Non-Entity Accounts Receivable:			
Disgorgement and Penalties (Note 16)	952,711	861,729	90,982
Other	1,329	1,195	134
Subtotal Non-Intragovernmental Accounts Receivable	1,077,106	863,080	214,026
Total Accounts Receivable	\$ 1,077,126	\$ 863,080	\$ 214,046

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At September 30, 2010, accounts receivable consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Gross Receivables	Allowance	Net Receivables
Intragovernmental Entity Accounts Receivable:			
Reimbursable Activity	\$ —	\$ —	\$ —
Subtotal Intragovernmental Accounts Receivable	—	—	—
Entity Accounts Receivable:			
Securities Transaction Fees	78,461	—	78,461
Filing Fees	690	107	583
Other	180	24	156
Non-Entity Accounts Receivable:			
Disgorgement and Penalties (Note 16)	656,495	574,556	81,939
Other	9	5	4
Subtotal Non-Intragovernmental Accounts Receivable	735,835	574,692	161,143
Total Accounts Receivable	\$ 735,835	\$ 574,692	\$ 161,143

Refer to Note 1.J. Accounts Receivable and Allowance for Uncollectible Accounts for methods used to estimate allowances. The SEC estimates that accrued interest (compounded and simple) on uncollectible disgorgement and penalty related accounts receivable to be \$138 million as of September 30, 2011. This estimate does not include interest accruable on debts referred to Treasury for collection.

As of September 30, 2011 and 2010, the balances include disgorgement and penalty accounts receivables, net of allowance, of \$51.7 million and \$42.4 million, respectively designated as payable to the U.S. Treasury General Fund per court order. As discussed in Note 1.M. Liabilities, these receivables, their offsetting liabilities, and the associated revenues, are classified as custodial.

NOTE 7. Property and Equipment, Net

At September 30, 2011, property and equipment consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Depreciation/ Amortization Method	Capitalization Threshold for Individual Purchases	Capitalization Threshold for Bulk Purchases	Service Life (Years)	Acquisition Cost	Accumulated Depreciation/ Amortization	Book Value
Furniture and Equipment	S/L	\$ 15	\$ 50	3-5	\$ 81,626	\$ 47,455	\$ 34,171
Software	S/L	300	300	3-5	97,139	80,392	16,747
Leasehold Improvements	S/L	300	N/A	10	90,993	47,972	43,021
Total					\$ 269,758	\$ 175,819	\$ 93,939

At September 30, 2010, property and equipment consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Depreciation/ Amortization Method	Capitalization Threshold for Individual Purchases	Capitalization Threshold for Bulk Purchases	Service Life (Years)	Acquisition Cost	Accumulated Depreciation/ Amortization	Book Value
Furniture and Equipment	S/L	\$ 15	\$ 50	3-5	\$ 61,133	\$ 42,754	\$ 18,379
Software	S/L	300	300	3-5	89,827	73,305	16,522
Leasehold Improvements	S/L	300	N/A	10	84,204	39,393	44,811
Total					\$ 235,164	\$ 155,452	\$ 79,712

NOTE 8. Liabilities

The SEC's liabilities include amounts that will not require the use of budgetary resources. These liabilities include registrant deposit accounts that have not been returned to registrants and the offsetting liability that corresponds to assets the SEC holds relating to collections from disgorgements and penalties and receivables as discussed in *Note 1.M. Liabilities*.

At September 30, 2011, liabilities consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Liabilities Covered by Budgetary Resources	Liabilities Not Covered by Budgetary Resources	Liabilities Not Requiring Budgetary Resources	Total
Intragovernmental:				
Accounts Payable	\$ 8,049	\$ —	\$ —	\$ 8,049
Other Intragovernmental Liabilities				
Accrued Employee Benefits	2,877	—	—	2,877
Unfunded FECA and Unemployment Liability	—	1,770	—	1,770
Custodial Liability	—	—	51,745	51,745
Liability for Non-Entity Assets	—	—	134	134
Subtotal – Other Intragovernmental Liabilities	2,877	1,770	51,879	56,526
Total Intragovernmental	10,926	1,770	51,879	64,575
Accounts Payable	52,768	—	—	52,768
Actuarial FECA Liability	—	7,805	—	7,805
Other Liabilities				
Accrued Payroll and Benefits	18,395	—	—	18,395
Accrued Leave	—	45,472	—	45,472
Registrant Deposits	—	—	46,622	46,622
Liability for Disgorgement and Penalties (Note 16)	—	—	862,976	862,976
Other Accrued Liabilities				
Legal Liability	—	956	—	956
Recognition of Lease Liability (Note 9)	—	6,256	—	6,256
Other	—	—	—	—
Subtotal – Other Liabilities	18,395	52,684	909,598	980,677
Total Liabilities (Note 11)	\$ 82,089	\$ 62,259	\$ 961,477	\$ 1,105,825

Other Liabilities totaled \$1,037 million as of September 30, 2011 and is comprised of current and non-current liabilities totaling \$986 million and \$51 million, respectively. The non-current portion of Other Liabilities includes the appropriate portions of the Unfunded FECA and Unemployment Liability, Accrued Leave, and Lease Liability. Current liabilities not covered by budgetary resources totaled \$3.6 million as of September 30, 2011.

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At September 30, 2010, liabilities consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Liabilities Covered by Budgetary Resources	Liabilities Not Covered by Budgetary Resources	Liabilities Not Requiring Budgetary Resources	Total
Intragovernmental:				
Accounts Payable	\$ 5,185	\$ —	\$ —	\$ 5,185
Other Intragovernmental Liabilities				
Accrued Employee Benefits	6,088	—	—	6,088
Unfunded FECA and Unemployment Liability	—	1,719	—	1,719
Custodial Liability	—	—	42,380	42,380
Liability for Non-Entity Assets	—	—	4	4
Subtotal – Other Intragovernmental Liabilities	6,088	1,719	42,384	50,191
Total Intragovernmental	11,273	1,719	42,384	55,376
Accounts Payable	46,260	—	—	46,260
Actuarial FECA Liability	—	7,576	—	7,576
Other Liabilities				
Accrued Payroll and Benefits	31,649	—	—	31,649
Accrued Leave	—	45,629	—	45,629
Registrant Deposits	—	—	44,729	44,729
Liability for Disgorgement and Penalties (Note 16)	—	—	1,021,466	1,021,466
Other Accrued Liabilities				
Legal Liability	—	10,823	—	10,823
Recognition of Lease Liability (Note 9)	—	9,202	—	9,202
Other	9,245	—	—	9,245
Subtotal – Other Liabilities	40,894	65,654	1,066,195	1,172,743
Total Liabilities (Note 11)	\$ 98,427	\$ 74,949	\$ 1,108,579	\$ 1,281,955

Other Liabilities totaled \$1,223 million as of September 30, 2010 and is comprised of current and non-current liabilities totaling \$1,170 million and \$53 million, respectively. The non-current portion of Other Liabilities includes the appropriate portions of the Unfunded FECA and Unemployment Liability, Accrued Leave, and Lease Liability. Current liabilities not covered by budgetary resources totaled \$14.4 million as of September 30, 2010.

The legal liability arose from an award ordered pursuant to case *SEC v. FLRA*, No. 08-1256, 08-1294 (D.C.Cir.). This matter involved a complaint filed by the National Treasury Employees Union (NTEU) before Federal Labor Relations Authority (FLRA). In FY 2010, the SEC developed a methodology for processing the ordered retroactive wage adjustments and began making payments in the fourth quarter of FY 2010. As of September 30, 2011, the remaining legal liability is estimated to be \$1 million.

NOTE 9. Leases

Operating Leases

At September 30, 2011, the SEC leased office space at 20 locations under operating lease agreements that expire between FY 2012 and FY 2027. The SEC paid \$99.6 million and \$93.3 million for rent for the fiscal years ending September 30, 2011 and 2010, respectively.

Under existing commitments, minimum lease payments through FY 2017 and thereafter are as follows:

Fiscal Year (DOLLARS IN THOUSANDS)	Minimum Lease Payments
2012	\$ 92,203
2013	95,907
2014	98,169
2015	94,462
2016	91,152
2017 and thereafter	369,849
Total Future Minimum Lease Payments	\$ 841,742

The total future minimum lease payments presented above include rented space through all optional lease periods.

Continuing Liability

The total future minimum lease payments summarized above includes a continuing liability, until March 31, 2012, for space leased in New York. In FY 2005, to facilitate surrender of the SEC lease obligations for this space, the SEC and U.S. General Services Administration (GSA) entered into separate agreements with the lessor. Under these agreements (including renewals), GSA has agreed to rent the office space for a period of time extending past the end of the SEC's lease term (March 2012). The SEC was responsible for a difference of approximately \$18 million between its lease liability and the lease amount negotiated by GSA. As of September 30, 2011, the SEC is responsible for approximately \$1 million in payments for the space leased in New York. The amount will be paid in FY 2012 and is included in the total future minimum lease payments disclosed in the Operating Leases section above.

Constitution Center Property

The total future minimum lease payments summarized above includes \$137.7 million for the Constitution Center property, for which a lease became effective on July 28, 2010. The lease was originally for 900,000 square feet of space. Subsequently, the landlord submitted a notification that 600,000 square feet had been assumed by two different third parties. Therefore, the minimum lease payments above reflect the SEC's obligation for the remaining 300,000 square feet. The SEC is also discussing with the General Services Administration (GSA) the possibility of transferring the remaining 300,000 square feet to GSA.

Expense Recognition of "Rent Holiday"

In addition to the lease liability above, in FY 2005 the SEC moved into temporary office space in New York due to renovations in the new leased office space. This temporary space was provided to the SEC for only the lessor's operating costs. As a result, the SEC did not make rent payments for the New York office for five months of the fiscal year. The SEC allocated the \$8 million of rent expense foregone on a straight-line basis over the life of the new lease. Since 2006, the SEC has recorded a reduction in the unfunded lease liability in the amount of \$2.9 million and currently has a remaining balance of \$5.1 million. The yearly future amortization amounts are shown in the table below. Refer to Recognition of Lease Liability line in *Note 8. Liabilities*.

Fiscal Year (DOLLARS IN THOUSANDS)	Future Amortization Amounts
2012	\$ 533
2013	533
2014	533
2015	533
2016	533
2017 and thereafter	2,399
Total Future Amortization Amounts	\$ 5,064

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NOTE 10. Commitments and Contingencies**A. Commitments: Securities Investor Protection Act**

The Securities Investor Protection Act of 1970 (SIPA), as amended, created the Securities Investor Protection Corporation (SIPC) to restore funds and securities to investors and to protect the securities markets from disruption following the failure of broker-dealers. Generally, if a brokerage firm is not able to meet its obligations to customers, then customers' cash and securities held by the brokerage firm are returned to customers on a pro rata basis. If sufficient funds are not available at the firm to satisfy customer claims, the reserve funds of SIPC are used to supplement the distribution, up to a ceiling of \$500,000 per customer, including a maximum of \$250,000 for cash claims.

SIPA authorizes SIPC to create a fund to maintain all monies received and disbursed by SIPC. SIPA gives SIPC the authority to borrow up to \$2.5 billion from the SEC in the event that the SIPC Fund is or may appear insufficient for purposes of SIPA. To borrow the funds, SIPC must file with the SEC a statement of the uses of such a loan and a repayment plan, and then the SEC must certify to the Secretary of the Treasury that the loan is necessary to protect broker-dealer customers and maintain confidence in the securities markets and that the repayment plan provides as reasonable assurance of prompt repayment as may be feasible under the circumstances. The Treasury would make these funds available to the SEC through the purchase of notes or other obligating instruments issued by the SEC. Such notes or other obligating instruments would bear interest at a rate determined by the Secretary of the Treasury. As of September 30, 2011, the SEC had not loaned any funds to the SIPC, and there are no outstanding notes or other obligating instruments issued by the SEC.

Based on the estimated costs to complete ongoing customer protection proceedings, the current size of the SIPC Fund supplemented by SIPC's ongoing assessments on brokers is expected to provide sufficient funds to cover acknowledged customer claims. There are several broker-dealers that are being liquidated under SIPA or that have been referred to SIPC for liquidation that may result in additional customer claims. In the event that the SIPC Fund is or may reasonably appear to be insufficient for the purposes of SIPA, SIPC may seek a loan from the SEC.

B. Commitments: Investor Protection Fund

As mentioned in *Note 1.E. Fund Accounting Structure*, the Investor Protection Fund will be used to pay awards to whistleblowers if they voluntarily provide original information to the SEC and meet other conditions. The legislation allows whistleblowers to receive between 10 and 30 percent of the monetary sanctions collected in the covered action or in a related action, with the actual percentage being determined at the discretion of the SEC using criteria provided in the legislation and the related rules to implement the legislation adopted by the SEC.

A contingent liability is recognized in instances where a positive Preliminary Determination has been made by the Claims Review Staff in the Office of the Whistleblower and the amount can be estimated. A Preliminary Determination is a first assessment, made by the Claims Review Staff, as to whether the claim should be allowed or denied and, if allowed, what the proposed award percentage amount should be. Liabilities are recognized in instances where a collection has been received and a positive Proposed Final Determination has been reached by the Claims Review Staff. However, the actual payment of the whistleblower award would not occur until after the Determination became final.

C. Other Commitments

In addition to future lease commitments discussed in *Note 9. Leases*, the SEC is obligated for the purchase of goods and services that have been ordered, but not received. As of September 30, 2011, net obligations for all of the SEC's activities were \$1,110.6 million, of which \$82.1 million was delivered and unpaid. As of September 30, 2010, net obligations for all of SEC's activities were \$317.7 million, of which \$98.4 million was delivered and unpaid.

D. Contingencies

The SEC recognizes contingent liabilities when a past event or exchange transaction has occurred, a future outflow or other sacrifice of resources is probable, and the future outflow or sacrifice of resources is measurable. The SEC is party to various routine administrative proceedings, legal actions, and claims brought against it, including threatened or pending litigation involving labor relations claims, some of which may ultimately result in settlements or decisions against the Federal Government. No such matters were probable and measurable at September 30, 2011.

NOTE 11. Earmarked, Other Entity, Disgorgement and Penalties, and Other Non-Entity Funds

SEC's Earmarked funds consist of transactions and balances recorded in its Salaries and Expenses (X0100) and the Investor Protection (X5567) funds, see Note 1.F. Earmarked Funds. SEC's Other Entity Funds consist of amounts recorded in its supplemental appropriation which was available for use in FY 2009 and FY 2010; see Note 1.E. Fund Accounting Structure.

Amounts disclosed as Disgorgement and Penalties consist of non-entity custodial and Governmental liabilities and related assets stemming from SEC's actions to collect disgorgement, penalties, and investment interest; refer to Note 1.M. Liabilities - Enforcement Related Liabilities.

Other Non-Entity Funds mainly consist of liabilities and related assets stemming from excess filing fees (registrant deposits), FOIA fees, and post judgment interest; refer to Note 1.G. Entity and Non-Entity Assets.

For FY 2011, the assets, liabilities, net position, and net income from operations relating to earmarked, other entity, disgorgement and penalties, and other non-entity funds consisted of the following:

<small>(DOLLARS IN THOUSANDS)</small>	Earmarked-Salaries & Expenses	Earmarked-Investor Protection Fund	Eliminations	Total Earmarked Funds	Other Entity Funds	Disgorgement and Penalties	Other Non-Entity Funds	Total
Balance Sheet as of September 30, 2011								
ASSETS								
Fund Balance with Treasury	\$ 6,874,218	\$ 73	\$ —	\$ 6,874,291	\$ 768	\$ 73,929	\$ 46,622	\$ 6,995,610
Cash and Other Monetary Assets	—	—	—	—	—	—	—	—
Investments, Net	—	452,715	—	452,715	—	749,810	—	1,202,525
Accounts Receivable, Net	122,930	—	—	122,930	—	90,982	134	214,046
Advances and Prepayments	10,828	—	—	10,828	—	—	—	10,828
Property and Equipment, Net	92,736	—	—	92,736	1,203	—	—	93,939
Total Assets (Note 2)	\$ 7,100,712	\$ 452,788	\$ —	\$ 7,553,500	\$ 1,971	\$ 914,721	\$ 46,756	\$ 8,516,948
LIABILITIES								
Accounts Payable	\$ 60,783	\$ —	\$ —	\$ 60,783	\$ 34	\$ —	\$ —	\$ 60,817
Accrued Payroll and Benefits	21,272	—	—	21,272	—	—	—	21,272
FECA and Unemployment Liability	9,575	—	—	9,575	—	—	—	9,575
Accrued Leave	45,472	—	—	45,472	—	—	—	45,472
Custodial Liability	—	—	—	—	—	51,745	—	51,745
Liability for Non-Entity Assets	—	—	—	—	—	—	134	134
Registrant Deposits	—	—	—	—	—	—	46,622	46,622
Liability for Disgorgement and Penalties	—	—	—	—	—	862,976	—	862,976
Other Accrued Liabilities	7,212	—	—	7,212	—	—	—	7,212
Total Liabilities (Note 8)	144,314	—	—	144,314	34	914,721	46,756	1,105,825

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<i>(DOLLARS IN THOUSANDS)</i>	Earmarked-Salaries & Expenses	Earmarked-Investor Protection Fund	Eliminations	Total Earmarked Funds	Other Entity Funds	Disgorgement and Penalties	Other Non-Entity Funds	Total
NET POSITION								
Unexpended Appropriations	—	—	—	—	735	—	—	735
Cumulative Results of Operations	6,956,398	452,788	—	7,409,186	1,202	—	—	7,410,388
Total Net Position	6,956,398	452,788	—	7,409,186	1,937	—	—	7,411,123
Total Liabilities and Net Position	\$ 7,100,712	\$ 452,788	\$ —	\$ 7,553,500	\$ 1,971	\$ 914,721	\$ 46,756	\$ 8,516,948

Statement of Net Cost

For the year ended September 30, 2011

Gross Program Costs	\$ 1,145,097	\$ 112	\$ 112	\$ 1,145,097	\$ 415	\$ —	\$ 2,626	\$ 1,148,138
Less Earned Revenues Not Attributable to Program Costs	1,640,893	—	112	1,640,781	—	—	2,949	1,643,730
Net (Income) Cost from Operations	\$ (495,796)	\$ 112	\$ —	\$ (495,684)	\$ 415	\$ —	\$ (323)	\$ (495,592)

Statement of Changes in Net Position

For the year ended September 30, 2011

Cumulative Results of Operations								
Beginning Balances	\$ 6,426,222	\$ 451,910	\$ —	\$ 6,878,132	\$ 603	\$ —	\$ —	\$ 6,878,735
Appropriations Used	—	—	—	—	1,014	—	—	1,014
Non-Exchange Revenue	—	990	—	990	—	—	—	990
Imputed Financing	34,380	—	—	34,380	—	—	—	34,380
Other	—	—	—	—	—	—	(323)	(323)
Net Income (Cost) from Operations	495,796	(112)	—	495,684	(415)	—	323	495,592
Net Change	530,176	878	—	531,054	599	—	—	531,653
Cumulative Results of Operations	6,956,398	452,788	—	7,409,186	1,202	—	—	7,410,388
Unexpended Appropriations								
Beginning Balances	—	—	—	—	1,749	—	—	1,749
Appropriations Used	—	—	—	—	(1,014)	—	—	(1,014)
Total Unexpended Appropriations	—	—	—	—	735	—	—	735
Net Position, End of Period	\$ 6,956,398	\$ 452,788	\$ —	\$ 7,409,186	\$ 1,937	\$ —	\$ —	\$ 7,411,123

For FY 2010, the assets, liabilities, net position, and net income from operations relating to earmarked, other entity, disgorgement and penalties, and other non-entity funds consisted of the following:

<small>(DOLLARS IN THOUSANDS)</small>	Earmarked-Salaries & Expenses	Earmarked-Investor Protection Fund	Eliminations	Total Earmarked Funds	Other Entity Funds	Disgorgement and Penalties	Other Non-Entity Funds	Total
Balance Sheet as of September 30, 2010								
ASSETS								
Fund Balance with Treasury	\$ 6,436,463	\$ 451,910	\$ —	\$ 6,888,373	\$ 1,996	\$ 54,269	\$ 44,729	\$ 6,989,367
Cash and Other Monetary Assets	—	—	—	—	—	2,815	—	2,815
Investments, Net	—	—	—	—	—	924,823	—	924,823
Accounts Receivable, Net	79,200	—	—	79,200	—	81,939	4	161,143
Advances and Prepayments	4,579	—	—	4,579	—	—	—	4,579
Property and Equipment, Net	79,109	—	—	79,109	603	—	—	79,712
Total Assets (Note 2)	\$ 6,599,351	\$ 451,910	\$ —	\$ 7,051,261	\$ 2,599	\$ 1,063,846	\$ 44,733	\$ 8,162,439
LIABILITIES								
Accounts Payable	\$ 51,313	\$ —	\$ —	\$ 51,313	\$ 132	\$ —	\$ —	\$ 51,445
Accrued Payroll and Benefits	37,622	—	—	37,622	115	—	—	37,737
FECA and Unemployment Liability	9,295	—	—	9,295	—	—	—	9,295
Accrued Leave	45,629	—	—	45,629	—	—	—	45,629
Custodial Liability	—	—	—	—	—	42,380	—	42,380
Liability for Non-Entity Assets	—	—	—	—	—	—	4	4
Registrant Deposits	—	—	—	—	—	—	44,729	44,729
Liability for Disgorgement and Penalties	—	—	—	—	—	1,021,466	—	1,021,466
Other Accrued Liabilities	29,270	—	—	29,270	—	—	—	29,270
Total Liabilities (Note 8)	173,129	—	—	173,129	247	1,063,846	44,733	1,281,955
NET POSITION								
Unexpended Appropriations	—	—	—	—	1,749	—	—	1,749
Cumulative Results of Operations	6,426,222	451,910	—	6,878,132	603	—	—	6,878,735
Total Net Position	6,426,222	451,910	—	6,878,132	2,352	—	—	6,880,484
Total Liabilities and Net Position	\$ 6,599,351	\$ 451,910	\$ —	\$ 7,051,261	\$ 2,599	\$ 1,063,846	\$ 44,733	\$ 8,162,439
Statement of Net Cost								
For the year ended September 30, 2010								
Gross Program Costs	\$ 1,050,910	\$ —	\$ —	\$ 1,050,910	\$ 7,508	\$ —	\$ 5	\$ 1,058,423
Less Earned Revenues Not								
Attributable to Program Costs	1,382,691	—	—	1,382,691	—	—	165	1,382,856
Net (Income) Cost from Operations	\$ (331,781)	\$ —	\$ —	\$ (331,781)	\$ 7,508	\$ —	\$ (160)	\$ (324,433)

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<i>(DOLLARS IN THOUSANDS)</i>	Earmarked-Salaries & Expenses	Earmarked-Investor Protection Fund	Eliminations	Total Earmarked Funds	Other Entity Funds	Disgorgement and Penalties	Other Non-Entity Funds	Total
Statement of Changes in Net Position								
For the year ended September 30, 2010								
Cumulative Results of Operations								
Beginning Balances	\$ 6,058,225	\$ —	\$ —	\$ 6,058,225	\$ —	\$ —	\$ —	\$ 6,058,225
Appropriations Used	—	—	—	—	8,111	—	—	8,111
Non-Exchange Revenue	—	451,910	—	451,910	—	—	—	451,910
Imputed Financing	36,216	—	—	36,216	—	—	—	36,216
Other	—	—	—	—	—	—	(160)	(160)
Net Income (Cost) from Operations	331,781	—	—	331,781	(7,508)	—	160	324,433
Net Change	367,997	451,910	—	819,907	603	—	—	820,510
Cumulative Results of Operations	6,426,222	451,910	—	6,878,132	603	—	—	6,878,735
Unexpended Appropriations								
Beginning Balances	—	—	—	—	9,860	—	—	9,860
Appropriations Used	—	—	—	—	(8,111)	—	—	(8,111)
Total Unexpended Appropriations	—	—	—	—	1,749	—	—	1,749
Net Position, End of Period	\$ 6,426,222	\$ 451,910	\$ —	\$ 6,878,132	\$ 2,352	\$ —	\$ —	\$ 6,880,484

NOTE 12. Intragovernmental Costs and Exchange Revenue

The Statement of Net Cost presents the SEC's results of operations for its major programs. The SEC assigns all costs incurred to ten programs, consistent with its budget submissions. The full cost of SEC programs is the sum of (1) the costs of resources directly or indirectly consumed by those programs, and (2) the costs of identifiable supporting services provided by other responsibility segments within the agency. Typical examples of indirect costs include costs of general administrative services, technical support, security, rent, and operating and maintenance costs for buildings, equipment, and utilities. The SEC allocates support costs to its programs using activity-based cost accounting.

Intragovernmental costs arise from purchases of goods and services from other components of the Federal Government. In contrast, public costs are those which arise from the purchase of goods and services from non-Federal entities.

Exchange revenue is not directly assignable to a specific program and is presented in total. The Statement of Net Cost, for the fiscal years ended September 30, 2011 and 2010, with a breakout of intragovernmental and public costs is presented below.

(DOLLARS IN THOUSANDS)	FY 2011		
	Intragovernmental Gross Cost	Gross Cost with the Public	Total
SEC Programs:			
Enforcement	\$ 72,533	\$ 318,650	\$ 391,183
Compliance Inspections and Examinations	44,396	195,039	239,435
Corporation Finance	24,412	107,248	131,660
Trading and Markets	11,528	50,648	62,176
Investment Management	8,759	38,481	47,240
Risk, Strategy, and Financial Innovation	3,723	16,357	20,080
General Counsel	7,668	33,689	41,357
Other Program Offices	8,367	36,755	45,122
Agency Direction and Administrative Support	30,290	133,067	163,357
Inspector General	1,210	5,318	6,528
Total Program Costs	\$ 212,886	\$ 935,252	1,148,138
Less: Exchange Revenues			
Securities Transaction Fees			1,279,260
Securities Registration, Tender Offer, and Merger Fees			361,284
Other			3,186
Total Exchange Revenues			1,643,730
Net (Income) Cost from Operations			\$ (495,592)

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(DOLLARS IN THOUSANDS)	FY 2010		
	Intragovernmental Gross Cost	Gross Cost with the Public	Total
SEC Programs:			
Enforcement	\$ 61,669	\$ 293,782	\$ 355,451
Compliance Inspections and Examinations	39,798	189,591	229,389
Corporation Finance	22,757	108,409	131,166
Trading and Markets	9,388	44,719	54,107
Investment Management	8,306	39,567	47,873
Risk, Strategy, and Financial Innovation	3,148	14,995	18,143
General Counsel	6,901	32,879	39,780
Other Program Offices	8,432	40,171	48,603
Agency Direction and Administrative Support	22,300	106,231	128,531
Inspector General	933	4,447	5,380
Total Program Costs	\$ 183,632	\$ 874,791	1,058,423
Less: Exchange Revenues			
Securities Transaction Fees			1,163,633
Securities Registration, Tender Offer, and Merger Fees			218,755
Other			468
Total Exchange Revenues			1,382,856
Net (Income) Cost from Operations			\$ (324,433)

Intragovernmental exchange revenue was \$236 thousand and \$304 thousand for the fiscal years ending September 30, 2011 and 2010, respectively.

NOTE 13. Imputed Financing

A portion of the retirement benefits provided to SEC employees is funded by OPM. In accordance with Federal accounting standards, the SEC recognizes identified costs paid by OPM on behalf of the SEC as an expense. The funding for this expense is reflected as imputed financing on the Statement of Changes in Net Position. Costs paid by OPM on behalf of the SEC were \$34.4 million and \$36.2 million in FY 2011 and FY 2010, respectively.

NOTE 14. Status of Budgetary Resources

A. Apportionment Categories of Obligations Incurred

Category A funds are those amounts that are subject to quarterly apportionment by OMB, meaning that a portion of the annual appropriation is not available to the agency until apportioned each quarter. Category B funds represent budgetary resources distributed by a specified time period, activity, project, object, or a combination of these categories. The SEC's Category B funds represent amounts apportioned at the beginning of the fiscal year for the SEC's reimbursable and Investor Protection Fund activities. For the fiscal years ended September 30, 2011 and 2010, the SEC incurred obligations against Category A and Category B funds as follows:

Obligations Incurred <i>(DOLLARS IN THOUSANDS)</i>	FY 2011	FY 2010
Direct Obligations		
Category A	\$ 1,215,032	\$ 1,103,007
Category A – Change in Legal Interpretation for Lease Obligations	777,928	–
Category B – Investor Protection Fund	112	–
Total Direct Obligations	1,993,072	1,103,007
Reimbursable Obligations		
Category B	388	282
Total Obligations Incurred	\$ 1,993,460	\$ 1,103,289

In addition, the amounts of budgetary resources obligated for undelivered orders include \$1,028.5 million and \$219.3 million at September 30, 2011 and 2010, respectively.

B. Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

A comparison between the FY 2011 SBR and the actual FY 2011 data in the President's budget cannot be presented, as the FY 2013 President's budget which will contain FY 2011 actual data is not yet available; the comparison will be presented in next year's financial statements. There are no differences between the FY 2010 SBR and the FY 2010 data in the President's budget except for rounding differences of \$1 million in the Unobligated Balances and Obligated Balances, Net, End of Period.

C. Other Budgetary Disclosures

General Provisions of Appropriation

The SEC's annual appropriation bill contains general provisions which limit the amount that can be obligated for international conferences, International Organization of Securities Commission (IOSCO) dues, and representation expenses.

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Change in Legal Interpretation for Lease Obligations

The SEC was granted independent leasing authority in 1990. Based on a legal review of its statutory authority at the time, the SEC adopted a policy of obligating only the annual portion of lease payments due each year. On October 3, 2011, the Government Accountability Office (GAO) issued a decision that this longstanding practice of recording lease obligations only on an annual basis violated the recording statute, 31 U.S.C. sect. 1501(a)(1). Specifically, GAO's decision was that the SEC lacks statutory authority to obligate an amount less than the Government's total obligation. If the SEC lacks sufficient budget authority to cover this obligation, the SEC should report a violation of the Antideficiency Act (ADA).

The SEC recorded obligations in the same manner for all its leasing actions between the time the agency was granted independent leasing authority in 1990 and 2010. Further, the agency does not have sufficient remaining unobligated funds in the years in which the various leases were entered to cover the full obligations associated with those leases. As a result, the agency is reporting Antideficiency Act violations between 1990 and 2010.

The SEC appropriately obligated the Government's total financial responsibility for the three lease actions initiated in FY 2011. For the SEC's other 17 current leases for which Antideficiency Act violations occurred, obligations of \$778 million have been recorded.

Further, in a step that will help prevent a recurrence of this type of violation in the future, on August 1, 2011, the SEC and GSA entered into a Memorandum of Understanding pursuant to which the SEC agreed that all future lease acquisitions for the SEC's office space needs shall be performed by GSA, pursuant to GSA's leasing authority. GSA's leasing authority includes the express statutory authority to obligate funds for leases in the fiscal year for which payments are due. Accordingly, in the future, the SEC will recognize annual lease payments due to GSA in accordance with standard GSA lease procedures.

See Note 10.A. *Commitments: Securities Investor Protection Act*, for information on SEC borrowing authority.

**NOTE 15. Reconciliation of Net Cost of Operations (Proprietary) to Budget
(formerly the Statement of Financing)**

For the fiscal years ended September 30, 2011 and 2010:

<i>(DOLLARS IN THOUSANDS)</i>	FY 2011	FY 2010
RESOURCES USED TO FINANCE ACTIVITIES:		
Budgetary Resources Obligated:		
Obligations Incurred (Note 14)	\$ 1,993,460	\$ 1,103,289
Less: Spending Authority from Offsetting Collections and Recoveries	(1,637,034)	(1,461,657)
Net Obligations	356,426	(358,368)
Other Resources:		
Imputed Financing from Cost Absorbed by Others (Note 13)	34,380	36,216
Total Resources Used to Finance Activities	390,806	(322,152)
RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS:		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered But Not Yet Provided		
	(815,449)	(67,775)
Resources That Finance the Acquisition of Assets Capitalized on the Balance Sheet	(43,809)	(27,319)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(859,258)	(95,094)
Total Resources Used to Finance the Net Cost of Operations	(468,452)	(417,246)
COMPONENTS OF NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD:		
Components Requiring or Generating Resources in Future Periods:		
Change in Accrued Leave Liability	(157)	2,933
Change in Revenue Receivables Not Generating Resources until Collected	(43,710)	60,320
Change in Lease Liability	(2,946)	(3,311)
Change in Legal Liability	(9,867)	10,823
Change in Unfunded Liability	280	(7,824)
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	(56,400)	62,941
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	27,951	25,408
Revaluation of Assets or Liabilities	1,631	4,634
Other Costs that will not Require or Generate Resources	(322)	(170)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in Future Periods	29,260	29,872
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	(27,140)	92,813
Net (Income) Cost from Operations	\$ (495,592)	\$ (324,433)

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NOTE 16. Disgorgement and Penalties

The SEC's non-entity assets consist of disgorgement, penalties, and interest assessed against securities law violators by the Commission, administrative law judge, or in some cases, a court. The SEC also recognizes an equal and offsetting liability for these non-entity assets as discussed in *Note 1.M. Liabilities*. When the Commission or court issues an order for the SEC to collect disgorgement, penalties, and interest from securities law violators, the SEC establishes an account receivable due to the SEC. When collected, the SEC either (a) holds receipts in FBWT or Treasury investments pending distribution to harmed investors or (b) transfers to the Investor Protection Fund or the U.S. Treasury General Fund. Disbursements related to disgorgements and penalties include distributions to harmed investors, payments to tax authorities, and fees paid to plan administrators and the Bureau of Public Debt. When it is not practical to return funds to investors or when court orders expressly state that funds are to be remitted to the U.S. Treasury, the SEC transfers funds to the Investor Protection Fund or to the U.S. Treasury General Fund. The SEC does not record on its financial statements any amounts ordered to another Government entity such as a court, or a non-governmental entity such as a receiver. Additional details regarding disgorgement and penalties are presented in *Note 1.S. Disgorgement and Penalties*, *Note 2. Assets and Note 11. Earmarked, Other Entity, Disgorgement and Penalties, and Other Non-Entity Funds*.

At September 30, the net inflows and outflows for FBWT, Investments, and Accounts Receivable related to disgorgement and penalties consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	FY 2011	FY 2010
Fund Balance with Treasury:		
Beginning Balance	\$ 54,269	\$ 43,622
Collections	544,200	1,214,911
Purchases and Redemptions of Treasury Securities	175,520	1,036,168
Disbursements	(286,647)	(1,123,799)
Transfers to Investor Protection Fund	—	(451,910)
Transfers to Treasury	(413,413)	(664,723)
Total Fund Balance with Treasury (Note 2)	73,929	54,269
Cash and Other Monetary Assets:		
Beginning Balance	2,815	—
Net Activity	(2,815)	2,815
Total Cash and Other Monetary Assets (Notes 2 and 4)	—	2,815
Investments, Net:		
Beginning Balance	924,823	1,959,611
Net Activity	(175,013)	(1,034,788)
Total Investments, Net (Notes 2 and 5)	749,810	924,823
Accounts Receivable, Net:		
Beginning Balance	81,939	294,508
Net Activity	9,043	(212,569)
Total Accounts Receivable, Net (Notes 2 and 6)	90,982	81,939
Total Disgorgement and Penalties (Note 11)	\$ 914,721	\$ 1,063,846

Required Supplementary Information

FINANCIAL SECTION

Required Supplementary Information (Unaudited)

This section provides the Required Supplementary Information as prescribed by OMB Circular No. A-136, *Financial Reporting Requirements*.

Statement of Budgetary Resources by Fund

For the fiscal year ended September 30, 2011:

<i>(DOLLARS IN THOUSANDS)</i>	Salaries and Expenses and Other Funds	Supplemental Fund	Investor Protection Fund	Total
	X0100, 1435, 3220	09/10 0100	X5567	
BUDGETARY RESOURCES:				
Unobligated Balance, Brought Forward, October 1	\$ 37,332	\$ 107	\$ 451,910	\$ 489,349
Recoveries of Prior Year Unpaid Obligations	38,628	317	—	38,945
Budget Authority:				
Appropriation	—	—	(847)	(847)
Spending Authority from Offsetting Collections:				
Earned:				
Collected	1,598,067	—	—	1,598,067
Change in Receivables from Federal Sources	20	—	—	20
Change in Unfilled Customer Orders:				
Advance Received	—	—	—	—
Without Advance from Federal Sources	2	—	—	2
Subtotal	1,598,089	—	(847)	1,597,242
Temporarily not Available Pursuant to Public Law	(412,005)	—	—	(412,005)
Total Budgetary Resources	\$ 1,262,044	\$ 424	\$ 451,063	\$ 1,713,531
STATUS OF BUDGETARY RESOURCES:				
Obligations Incurred:				
Direct (Note 14)	\$ 1,215,032	\$ —	\$ 112	\$ 1,215,144
Direct, Change in Legal Interpretation for Lease Obligations (Note 14)	777,928	—	—	777,928
Reimbursable (Note 14)	388	—	—	388
Subtotal	1,993,348	—	112	1,993,460
Unobligated Balance:				
Apportioned	8,297	—	450,951	459,248
Unobligated Balance Not Available	(739,601)	424	—	(739,177)
Total Status of Budgetary Resources	\$ 1,262,044	\$ 424	\$ 451,063	\$ 1,713,531
CHANGE IN OBLIGATED BALANCE:				
Obligated Balance, Net:				
Unpaid Obligations, Brought Forward, October 1	\$ 315,883	\$ 1,889	\$ —	\$ 317,772
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(25)	—	—	(25)
Total Unpaid Obligated Balance, Net, Beginning of Fiscal Year	315,858	1,889	—	317,747
Obligations Incurred Net	1,993,348	—	112	1,993,460
Gross Outlays	(1,160,313)	(1,228)	(112)	(1,161,653)
Recoveries of Prior Year Unpaid, Obligations, Actual	(38,628)	(317)	—	(38,945)
Change in Uncollected Customer Payments from Federal Sources	(22)	—	—	(22)
Total, Unpaid Obligated Balance, Net, End of Period (Note 10)	\$ 1,110,243	\$ 344	\$ —	\$ 1,110,587
Obligated Balance, Net, End of Period:				
Unpaid Obligations	\$ 1,110,290	\$ 344	\$ —	\$ 1,110,634
Uncollected Customer Payments from Federal Sources	(47)	—	—	(47)
Total, Unpaid Obligated Balance, Net, End of Period (Note 10)	\$ 1,110,243	\$ 344	\$ —	\$ 1,110,587
NET OUTLAYS:				
Net Outlays:				
Gross Outlays	\$ 1,160,313	\$ 1,228	\$ 112	\$ 1,161,653
Offsetting Collections	(1,598,067)	—	—	(1,598,067)
Distributed Offsetting Receipts	(187)	—	847	660
Net Outlays/(Collections)	\$ (437,941)	\$ 1,228	\$ 959	\$ (435,754)

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Required Supplementary Information

FINANCIAL SECTION

For the fiscal year ended September 30, 2010:

<i>(DOLLARS IN THOUSANDS)</i>	Salaries and Expenses and Other Funds	Supplemental Fund	Investor Protection Fund	Total
	X0100, 3220, F3875	09/10 0100	X5567	
BUDGETARY RESOURCES:				
Unobligated Balance, Brought Forward, October 1	\$ 19,011	\$ 7,754	\$ —	\$ 26,765
Recoveries of Prior Year Unpaid Obligations	18,753	—	—	18,753
Budget Authority:				
Appropriation	—	—	451,910	451,910
Spending Authority from Offsetting Collections:				
Earned:				
Collected	1,443,347	—	—	1,443,347
Change in Receivables from Federal Sources	(188)	—	—	(188)
Change in Unfilled Customer Orders:				
Advance Received	(157)	—	—	(157)
Without Advance from Federal Sources	(98)	—	—	(98)
Subtotal	1,442,904	—	451,910	1,894,814
Temporarily not Available Pursuant to Public Law	(347,694)	—	—	(347,694)
Total Budgetary Resources	\$ 1,132,974	\$ 7,754	\$ 451,910	\$ 1,592,638
STATUS OF BUDGETARY RESOURCES:				
Obligations Incurred:				
Direct (Note 14)	\$ 1,095,360	\$ 7,647	\$ —	\$ 1,103,007
Direct, Change in Legal Interpretation for Lease Obligations (Note 14)	—	—	—	—
Reimbursable (Note 14)	282	—	—	282
Subtotal	1,095,642	7,647	—	1,103,289
Unobligated Balance:				
Apportioned	17,106	107	—	17,213
Unobligated Balance Not Available	20,226	—	451,910	472,136
Total Status of Budgetary Resources	\$ 1,132,974	\$ 7,754	\$ 451,910	\$ 1,592,638
CHANGE IN OBLIGATED BALANCE:				
Obligated Balance, Net:				
Unpaid Obligations, Brought Forward, October 1	\$ 234,292	\$ 2,107	\$ —	\$ 236,399
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(311)	—	—	(311)
Total Unpaid Obligated Balance, Net, Beginning of Fiscal Year	233,981	2,107	—	236,088
Obligations Incurred Net	1,095,642	7,647	—	1,103,289
Gross Outlays	(995,299)	(7,864)	—	(1,003,163)
Recoveries of Prior Year Unpaid, Obligations, Actual	(18,753)	—	—	(18,753)
Change in Uncollected Customer Payments from Federal Sources	286	—	—	286
Total, Unpaid Obligated Balance, Net, End of Period (Note 10)	\$ 315,857	\$ 1,890	\$ —	\$ 317,747
Obligated Balance, Net, End of Period:				
Unpaid Obligations	315,882	1,890	—	317,772
Uncollected Customer Payments from Federal Sources	(25)	—	—	(25)
Total, Unpaid Obligated Balance, Net, End of Period (Note 10)	\$ 315,857	\$ 1,890	\$ —	\$ 317,747
NET OUTLAYS:				
Net Outlays:				
Gross Outlays	\$ 995,299	\$ 7,864	\$ —	\$ 1,003,163
Offsetting Collections	(1,443,190)	—	—	(1,443,190)
Distributed Offsetting Receipts	194	—	—	194
Net Outlays/(Collections)	\$ (447,697)	\$ 7,864	\$ —	\$ (439,833)

IPF's Financial Statements

FINANCIAL SECTION

Investor Protection Fund Financial Statements

U.S. SECURITIES AND EXCHANGE COMMISSION
INVESTOR PROTECTION FUND

Balance Sheet

As of September 30, 2011 and 2010

(DOLLARS IN THOUSANDS)

	FY 2011	FY 2010
ASSETS:		
Intragovernmental:		
Fund Balance with Treasury (Note 2)	\$ 73	\$ 451,910
Investments, Net (Note 3)	452,715	—
Total Assets	\$ 452,788	\$ 451,910
LIABILITIES:		
Commitments and Contingencies (Note 4)		
NET POSITION:		
Cumulative Results of Operations – Earmarked Funds	\$ 452,788	\$ 451,910
Total Liabilities and Net Position	\$ 452,788	\$ 451,910

The accompanying notes are an integral part of these financial statements.

U.S. SECURITIES AND EXCHANGE COMMISSION
INVESTOR PROTECTION FUND

Statement of Net Cost

For the years ended September 30, 2011 and 2010

<i>(DOLLARS IN THOUSANDS)</i>	FY 2011	FY 2010
PROGRAM COSTS (Note 5):		
Employee Suggestion Program	\$ 112	\$ —
Total Program Costs	<u>112</u>	<u>—</u>
Net (Income) Cost from Operations	<u>\$ 112</u>	<u>\$ —</u>

The accompanying notes are an integral part of these financial statements.

U.S. SECURITIES AND EXCHANGE COMMISSION
INVESTOR PROTECTION FUND

Statement of Changes in Net Position

For the years ended September 30, 2011 and 2010

<i>(DOLLARS IN THOUSANDS)</i>	FY 2011	FY 2010
CUMULATIVE RESULTS OF OPERATIONS – EARMARKED FUNDS:		
Beginning Balances	\$ 451,910	\$ —
Budgetary Financing Sources:		
Non-Exchange Revenue	990	451,910
Net Income (Cost) from Operations	(112)	—
Net Change	<u>878</u>	<u>451,910</u>
Cumulative Results of Operations	<u>452,788</u>	<u>451,910</u>
Net Position, End of Period	<u>\$ 452,788</u>	<u>\$ 451,910</u>

The accompanying notes are an integral part of these financial statements.

FINANCIAL SECTION

U.S. SECURITIES AND EXCHANGE COMMISSION
INVESTOR PROTECTION FUND

Statement of Budgetary Resources

For the years ended September 30, 2011 and 2010

(DOLLARS IN THOUSANDS)

	FY 2011	FY 2010
BUDGETARY RESOURCES:		
Unobligated Balance, Brought Forward, October 1	\$ 451,910	\$ —
Budget Authority:		
Appropriation	(847)	451,910
Total Budgetary Resources	\$ 451,063	\$ 451,910
STATUS OF BUDGETARY RESOURCES:		
Obligations Incurred:		
Direct – Category B (Note 6)	\$ 112	\$ —
Unobligated Balance:		
Apportioned	450,951	—
Unobligated Balance Not Available	—	451,910
Total Status of Budgetary Resources	\$ 451,063	\$ 451,910
CHANGE IN OBLIGATED BALANCE:		
Obligations Incurred Net	\$ 112	\$ —
Gross Outlays	(112)	—
Total, Unpaid Obligated Balance, Net, End of Period (Note 6)	\$ —	\$ —
NET OUTLAYS:		
Net Outlays:		
Gross Outlays	\$ 112	\$ —
Distributed Offsetting Receipts	847	—
Net Outlays/(Collections)	\$ 959	\$ —

The accompanying notes are an integral part of these financial statements.

Notes to the Investor Protection Fund Financial Statements

U.S. SECURITIES AND EXCHANGE COMMISSION

As of September 30, 2011 and 2010

NOTE 1. Summary of Significant Accounting Policies

A. Reporting Structure

The United States Securities and Exchange Commission (SEC) is an independent agency of the United States Government established pursuant to the Securities Exchange Act of 1934 (Exchange Act), charged with regulating this country's capital markets. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) established the Securities and Exchange Commission Investor Protection Fund. The Investor Protection Fund provides funding for a Whistleblower Award Program and finances the operations of the SEC Office of the Inspector General's (OIG) employee suggestion program. The Investor Protection Fund is a fund within the SEC, and these financial statements present a segment of the SEC's financial activity.

B. Basis of Presentation and Accounting

The accompanying financial statements present the financial position, net cost of operations, changes in net position, and budgetary resources of the Investor Protection Fund as required by Exchange Act Section 21F(g)(5). The Act requires a complete set of financial statements that includes a balance sheet, income statement, and cash flow analysis. The Investor Protection Fund is a Federal reporting entity. As such, its financial statements are prepared in conformity with Generally Accepted Accounting Principles (GAAP) for the Federal Government, and are presented in conformity with OMB Circular A-136, *Financial Reporting Requirements*. The legislative requirements to prepare an income statement and cash flow analysis are addressed by the Statement of Net Cost and Note 2. *Fund Balance with Treasury*, respectively.

The SEC's books and records serve as the source of the information presented in the accompanying financial statements.

The agency classifies assets, liabilities, revenues, and costs in these financial statements according to the type of entity associated with the transactions. Intragovernmental assets and liabilities are those due from or to other Federal entities, including

those activities within the SEC. Intragovernmental revenues and costs result from transactions with other Federal entities.

The Balance Sheet, Statement of Net Cost and Statement of Changes in Net Position are prepared using the accrual basis of accounting. Accordingly, revenues are recognized when earned and expenses are recognized when incurred without regard to the receipt or payment of cash. These principles differ from budgetary accounting and reporting principles on which the Statement of Budgetary Resources is prepared. The statements may differ from other financial reports submitted pursuant to Office of Management and Budget (OMB) directives for the purpose of monitoring and controlling the use of budgetary resources, due to differences in applicable accounting and reporting principles discussed in the following paragraphs. Conceptually, the differences relate primarily to the capitalization and depreciation of property and equipment, as well as the recognition of other long-term assets and liabilities and are not currently applicable to the Investor Protection Fund.

C. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. These estimates and assumptions include the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

D. Intra- and Inter-Agency Relationships

Transactions with Other SEC Entities

The Investor Protection Fund is comprised of a single Federal Treasury Fund Symbol and has no intra-entity transactions. The Investor Protection Fund is the recipient of non-exchange revenues collected by the SEC and reported on the SEC's Statement of Custodial Activity. The Investor Protection

FINANCIAL SECTION

Fund finances the OIG's employee suggestion program on a reimbursable basis.

Accounts receivable that may be used to fund the Investor Protection Fund are recognized as assets of the SEC. These resources are not assets of the Investor Protection Fund until the determination is made to deposit collections in the Investor Protection Fund.

Transactions with Other Federal Agencies

Whistleblower payments may be made from the Investor Protection Fund as a result of monetary sanctions paid to other Federal agencies in related actions, but only if there has been a Commission enforcement action resulting in sanctions of a million dollars or greater and the Commission has determined that the whistleblower is eligible for an award and recommended the percentage. In those instances, the SEC remains liable for paying the whistleblower. However, in instances where a whistleblower has already received an award from the Commodity Futures Trading Commission (CFTC), the whistleblower is not entitled to an award from the SEC.

E. Earmarked Fund

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. Investor Protection Fund resources are earmarked and may only be used for the purposes specified by the Dodd-Frank Act.

F. Entity Assets

Assets that an agency is authorized to use in its operations are entity assets. The SEC is authorized to use all funds in the Investor Protection Fund for its operations. Accordingly, all assets are recognized as entity assets.

G. Fund Balance with Treasury

Fund Balance with Treasury reflects amounts the Investor Protection Fund holds in the U.S. Treasury that have not been invested in Federal securities. The SEC conducts all of its banking activity in accordance with directives issued by the United States Department of the Treasury's Financial Management Service.

H. Investments

The SEC has authority to invest amounts in the Investor Protection Fund in overnight and short-term, market-based Treasury securities. The interest earned on the investments is a component of the Fund and is available to be used for expenses of the Investor Protection Fund. Additional details regarding Investor Protection Fund investments are provided in *Note 3. Investments, Net*.

Market-based Treasury securities are debt securities that the U.S. Treasury issues to Federal entities without statutorily determined interest rates. Although the securities are not marketable, the terms (prices and interest rates) mirror the terms of marketable Treasury securities.

Treasury securities are an asset of the Investor Protection Fund and a liability of the U.S. Treasury. Because the Investor Protection Fund and the U.S. Treasury are both components of the Federal Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, the investments presented by the Investor Protection Fund do not represent an asset or a liability in the U.S. Government-wide financial statements.

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with the investment by Federal agencies in non-marketable Federal securities. The balances underlying these investments are deposited in the U.S. Treasury, which uses the cash for general Government purposes. When the Investor Protection Fund requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same manner in which the Government finances all expenditures.

I. Liabilities

The SEC records liabilities for probable future outflows or other sacrifices of resources as a result of events that have occurred as of the Balance Sheet date. Investor Protection Fund's liabilities will consist of payables to whistleblowers and reimbursable expenses that the Office of Inspector General incurs to operate the Employee Suggestion Program. There

are no liabilities or contingent liabilities related to the Investor Protection Fund as of September 30, 2011 and 2010, respectively.

The Dodd-Frank Act and the SEC implementing regulations establish the eligibility criteria for Whistleblower awards. Refer to *Note 4. Commitments and Contingencies* for information regarding the disclosure and recognition of actual and contingent liabilities for Whistleblower awards.

J. Program Costs

The Investor Protection Fund reimburses the SEC's General Fund (X0100) for expenses incurred by the Office of Inspector General to administer the Employee Suggestion Program. The Investor Protection Fund also finances payments to whistleblowers under Section 21F of the Exchange Act. The SEC adopted the final rules to implement the Whistleblower Program on May 25, 2011. As of September 30, 2011, there are no amounts paid or payable under the Whistleblower Program.

K. Non-Exchange Revenue

Disgorgement and Penalty Transfers

Non-exchange revenue arises from the Government's ability to demand payment. The Investor Protection Fund is financed through the receipt of portions of monetary sanctions collected by the SEC in judicial or administrative actions brought by the SEC under the securities laws that are not either: (1) added to the disgorgement fund or other fund under Section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246) or (2) otherwise distributed to victims of a violation of the securities laws. The Investor Protection Fund recognizes non-exchange revenue for disgorgement and penalty amounts transferred into the fund from the SEC's Disgorgement and Penalties Fund (X6563). No sanction collected by the SEC can be deposited into the Investor Protection Fund if the balance in the fund exceeds \$300 million on the day of collection.

Interest Earnings on Investments with Treasury

Interest earned from investments in U.S. Treasury securities is classified in the same way as the predominant source of revenue to the fund. The Investor Protection Fund is financed through the receipt of non-exchange revenues and thus interest earnings are also recognized as non-exchange revenues.

L. Budgets and Budgetary Accounting

The Investor Protection Fund (Fund X5567) is a special fund established through a permanent indefinite appropriation that has the authority to retain revenues and other financing sources not used in the current period for future use. The Dodd-Frank Act provides that the Fund is available to the SEC without further appropriation or fiscal year limitation for the purpose of paying awards to whistleblowers and funding the activities of the OIG's employee suggestion program. However, the SEC is required to request and obtain an annual apportionment from OMB to use these funds. In FY 2010, the SEC received a \$451.9 million apportionment for the Fund for use in FY 2011.

The resources of the Investor Protection Fund are apportioned under Category B authority, which means that the funds represent budgetary resources distributed by a specified time period, activity, project, object, or a combination of these categories and are not subject to quarterly apportionment. Thus, all obligations incurred as presented on the Statement of Budgetary Resources are derived from Category B funds.

FINANCIAL SECTION

NOTE 2. Fund Balance with Treasury

The Fund Balance with Treasury by type of fund and Status of Fund Balance with Treasury as of September 30, 2011 and 2010 consists of the following:

<i>(DOLLARS IN THOUSANDS)</i>	FY 2011	FY 2010
Fund Balances:		
Special Fund	\$ 73	\$ 451,910
Total Fund Balance with Treasury	\$ 73	\$ 451,910
Status of Fund Balance with Treasury:		
Unobligated Balance		
Available	\$ 73	\$ —
Unavailable	—	451,910
Total Fund Balance with Treasury	\$ 73	\$ 451,910

Unobligated balances reported for the status of Fund Balance with Treasury do not agree with the amounts reported in the Statement of Budgetary Resources due to the fact that unobligated balances are not reduced when investments are purchased.

There were no differences between the Fund Balance reflected in the Investor Protection Fund financial statements and the balance in the Treasury accounts.

Cash flow

The Investor Protection Fund cash flows are reflected in investments and in the Statement of Budgetary Resources. Such cash flows during FY 2011 consisted of net investment purchases of \$453.8 million (which includes \$2 million of reinvested interest of the total \$2.1 million interest received), and the cost of operating the OIG Employee Suggestion Program of \$112 thousand. Cash flows during FY 2010 consisted of a transfer from Disbursements and Penalties of \$451.9 million.

NOTE 3. Investments, Net

The SEC invests funds in overnight and short-term non-marketable market-based Treasury bills. The SEC records the value of its investments in Treasury bills at cost and amortizes any premium or discount on a straight-line basis (S/L) through the maturity date of these securities. Non-marketable market-based Treasury securities are issued by the Bureau of Public Debt to Federal agencies. They are not traded on any securities exchange but mirror the prices of similar Treasury securities trading in the Government securities market.

At September 30, 2011, investments consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investment, Net	Market Value Disclosure
Non-Marketable Market-Based Securities						
Investor Protection Fund – Entity	\$453,799	S/L	\$ (2,314)	\$ 1,230	\$452,715	\$451,696

NOTE 4. Commitments and Contingencies

As mentioned in *Note 1.I. Liabilities*, the Investor Protection Fund will be used to pay awards to whistleblowers if they voluntarily provide original information to the SEC and meet other conditions. The legislation allows whistleblowers to receive between 10 and 30 percent of the monetary sanctions collected in the covered action or in a related action, with the actual percentage being determined at the discretion of the SEC using criteria provided in the legislation and the related rules to implement the legislation adopted by the SEC.

A contingent liability is recognized in instances where a positive Preliminary Determination has been made by the Claims Review Staff in the Office of the Whistleblower and the amount can be estimated. A Preliminary Determination is a first assessment, made by the Claims Review Staff, as to whether the claim should be allowed or denied and, if allowed, setting forth the proposed award percentage amount. Liabilities are recognized in instances where a collection has been received and a positive Proposed Final Determination has been reached by the Claims Review Staff. However, the actual payment of the whistleblower award would not occur until after the Determination became final.

NOTE 5. Intragovernmental Costs

The Statement of Net Cost presents the Investor Protection Fund's results of operations for its two activities: the Employee Suggestion Program and Payments to Whistleblowers.

Intragovernmental costs arise from purchases of goods and services from other components of the Federal Government (including other SEC funds). In contrast, public costs are those which arise from the purchase of goods and services from non-Federal entities. The Employee Suggestion Program incurred \$111 thousand of intragovernmental costs and \$1 thousand of costs with the public in FY 2011.

NOTE 6. Status of Budgetary Resources

A. Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

A comparison between the FY 2011 Statement of Budgetary Resources (SBR) and the actual FY 2011 data in the President's budget cannot be presented, as the FY 2013 President's budget which will contain FY 2011 actual data is not yet available; the comparison will be presented in next year's financial statements. There are no differences between the FY 2010 SBR and the FY 2010 data in the President's budget.

B. Other Budgetary Disclosures

There are no budgetary resources obligated for undelivered orders as of September 30, 2011.

There are no legal arrangements affecting the use of unobligated balances of budget authority, such as time limits, purpose, and obligation limitations.

FINANCIAL SECTION

**NOTE 7. Reconciliation of Net Cost of Operations (Proprietary) to Budget
(formerly the Statement of Financing)**

For the fiscal year ended September 30, 2011, Obligations Incurred equaled the Net Cost of Operations and there were no reconciling items. For the fiscal year ended September 30, 2010, there was no activity in either Obligations Incurred or the Net Cost of Operations.

Comments from the United States Securities and Exchange Commission



THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

November 10, 2011

Mr. James R. Dalkin
Director
Financial Management and Assurance
United States Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Dalkin:

Thank you for the opportunity to review and comment on the audit report of the Government Accountability Office (GAO). I am pleased that the GAO's FY 2011 audit found that the SEC's financial statements and notes were presented fairly, in all material respects, and in conformity with U.S. generally accepted accounting principles.

Furthermore, I am delighted the GAO found that the SEC has successfully remediated the two material weaknesses identified in 2010. Under the newly-completed leadership team of the Chief Operating Officer, Chief Financial Officer, Chief Information Officer, and Chief Accounting Officer, the SEC has treated this remediation effort as a top priority, and GAO's opinion confirms the significant progress the agency has made in strengthening its internal controls.

Although I am gratified by this achievement, the SEC's efforts in this area will not cease. The SEC will continue working to ensure that our controls infrastructure is strong and sustainable over the long term. In this regard, the agency has been engaged in a multi-year effort to migrate its core financial system to the Federal Shared Service Provider (FSSP) at the Department of Transportation's Enterprise Services Center (ESC). Through this initiative, the SEC will realize improvements in system functionality, automate some manual processes, and further enhance financial management and reporting. The SEC plans to complete the migration in FY 2012.

In addition, in FY 2012 the SEC will continue remediation related to the remaining deficiency areas identified in your report. The SEC plans further progress on tightening information security, resolving the backlog of inactive registrant deposit accounts, bolstering controls over budgetary resources, and completing implementation of our new program governing the use of spreadsheets and databases related to financial reporting. We welcome GAO's feedback on these initiatives throughout the process.

**Appendix I
Comments from the United States Securities
and Exchange Commission**

Mr. James R. Dalkin
Page 2

I very much appreciate the professional manner in which you and your team conducted the audit for FY 2011. I look forward to continuing our productive dialogue in the coming months on the financial system migration and the SEC's efforts to address the areas noted in your report. If you have any questions, please feel free to contact me.

Sincerely,



Mary L. Schapiro
Chairman

GAO Contact and Staff Acknowledgments

GAO Contact

James R. Dalkin, (202) 512-9406 or dalkinj@gao.gov

Staff Acknowledgments

In addition to the contact named above, the following individuals made key contributions to this report: Kristen A. Kociolek, Lead Assistant Director; Edward R. Alexander, Jr.; Angela M. Bell; Sharon O. Byrd; Cheryl E. Clark; Lauren S. Fassler; Clayton T. Clark; Edmund F. Fernandez; Meafelia P. Gusukuma; Jacquelyn Hamilton; Bernice M. Lemaire; Katherine Shea Lenane; Chelsea J. Lounsbury; Matthew C. O'Connor; Laura S. Pacheco; David E. Ramirez; Sabrina Rivera; Andrew D. Seehusen; Eric Stalcup; Henry I. Sutanto; and Charles M. Vrabel.

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